No. 90-762-CFX
Status: GRANTED

Title: Thomas Freytag, et al., Petitioners
v.
Commissioner of Internal Revenue

Docketed:
November 13, 1990

Court: United States Court of Appeals
for the Fifth Circuit

Counsel for petitioner: Sullivan,Kathleen M.

Counsel for respondent: Solicitor General

40 copies mailed 11/13 and recd. 11/14.

Entry	Date	Note	Proceedings and Orders
1	Nov 13 1990	G	Petition for writ of certiorari filed.
3	Dec 10 1990		Order extending time to file response to petition until January 14, 1991.
4	Dec 19 1990		DISTRIBUTED. January 11, 1991
5	Dec 19 1990	X	Brief of respondent Commissioner of Internal Revenue in opposition filed.
6	Dec 28 1990	X	Reply brief of petitioners Thomas Freytag, et al. filed.
8	Jan 14 1991		REDISTRIBUTED. January 18, 1991
9	Jan 22 1991		Petition GRANTED. In addition to the questions presented by the petition the parties are requested to brief and argue the following question: "Does a party's consent to have its case heard by a special tax judge constitute a waiver of any right to challenge the appointment of that judge on the basis of the Appointments Clause, Art. II, Section 2, cl. 2?" **
10	Jan 25 1991		Record filed.
		*	Certified copy of original record received. (2 boxes).
11	Jan 30 1991		Record filed.
		*	Certified copy of C. A. Proceedings received. (2 volumes).
12	Feb 1 1991	G	Motion of Erwin N. Griswold for leave to appear as amicus curiae filed.
13	Feb 1 1991	D	Motion of Erwin N. Griswold for leave to file amicus curiae brief at the time the brief of the respondent is filed filed.
14	Feb 1 1991	D	Motion of Erwin N. Griswold for leave to participate in oral argument as amicus curiae and for divided argument filed.
15	Feb 7 1991		Petitioner's objection to motions of Erwin N. Griswold for leave to appear as amicus curiae, for leave to file amicus brief at the time the brief of the respondent is filed, and for leave to participate in oral argument filed.
16	Feb 19 1991		Motion of Erwin N. Griswold for leave to appear as amicus curiae GRANTED.
17	Feb 19 1991		Motion of Erwin N. Griswold for leave to file amicus curiae brief at the time the brief of the respondent is filed DENIED.
18	Feb 19 1991		Motion of Erwin N. Griswold for leave to participate in

No. 90-762-CFX

Entry	Date	Note	Proceedings and Orders
			oral argument as amicus curiae and for divided argument DENIED.
19	Feb 27 1991		SET FOR ARGUMENT TUESDAY, APRIL 23, 1991. (2ND CASE)
20	Mar 1 1991		Joint appendix filed.
21	Mar 1 1991		Brief of petitioners Thomas Freytag, et al. filed.
22	Mar 8 1991		Brief amicus curiae of Erwin N. Griswold filed.
23	Mar 22 1991		CIRCULATED.
24	Apr 3 1991	X	Brief of respondent Commissioner of Internal Revenue filed.
25	Apr 5 1991	X	Supplemental brief of respondent Commissioner of Internal Revenue filed.
26	Apr 16 1991	X	Reply brief of petitioners Thomas Freytag, et al. filed.
27	Apr 23 1991		ARGUED.

90-782
FILED
NOV 13 1990
JOSEPH F. SPANIOL, JR.

No. 90-

IN THE
Supreme Court of the United States

OCTOBER TERM, 1990

THOMAS AND SHARON FREYTAG, JOE AND GLADYS WOMBLE, BERT AND MILDRED TIMM, KENNETH AND CANDACE McCOIN,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

KATHLEEN M. SULLIVAN
Counsel of Record
BRIAN STUART KOUKOUTCHOS
1525 Massachusetts Avenue
Cambridge, Massachusetts 02138
(617) 495-4633

RICHARD J. SIDEMAN
MARTHA A. BOERSCH
SIDEMAN & BANCROFT
One Embarcadero Center
Suite 860
San Francisco, California 94111
(415) 392-1960
Counsel for Petitioners

November 13, 1990

BATEMAN & SLADE, INC. BOSTON, MASSACHUSETTS

QUESTIONS PRESENTED

1. Are complex tax cases affecting thousands of parties and billions of dollars among the "other proceeding[s]" that 26 U.S.C. § 7443A(b)(4) allows the United States Tax Court to assign to a special trial judge for trial and effective resolution?

2. Does the Appointments Clause of Art. II, § 2, which allows Congress to confer power to appoint inferior officers on the "Courts of Law" and the "Heads of Departments," permit Congress to grant the chief judge of the Tax Court power to appoint special trial judges?

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

Constitutional Provisions:

Statutes:

Regulations:

Rules:

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit is reported at 904 F.2d 1011 and reprinted as Appendix A. The opinion of the United States Tax Court is reported at 89 T.C. 849 and reprinted as Appendix B.

JURISDICTION

The decision of the Court of Appeals was entered on July 6, 1990. A timely petition for rehearing was denied on August 15, 1990. *See* Appendix D. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISIONS, STATUTE AND RULE INVOLVED

The pertinent portions of Art. I, § 8, Art. II, § 2, and Art. III, §§ 1-2 are set forth in Appendix E. The text of 26 U.S.C. § 7443A is set forth in Appendix F. Tax Court Rule 183 is set forth in the Appendix at A91-92.[1]

STATEMENT OF THE CASE

At issue in this case is whether a complex tax deficiency matter involving three thousand taxpayers and approximately $1.5 billion in alleged tax deficiencies may be tried and effec-

[1] Citations to the appendix bound with this petition will be styled "A ."

tively decided by a "special trial judge" appointed by the Tax Court, rather than by a duly-appointed judge of the Tax Court itself. The Tax Court is an Article I court consisting of 19 judges appointed by the President with the advice and consent of the Senate to 15-year terms. *See* 26 U.S.C. §§ 7443(a),(b) and (e); (A73). Special trial judges, who currently preside over 42% of the Tax Court's docket,[2] are appointed by the chief judge of the Tax Court for indefinite terms, under the authority of 26 U.S.C. § 7443A(a). (A100). Petitioners are taxpayers whose deficiency cases were effectively decided by a special trial judge rather than a duly-appointed Tax Court judge.

Petitioners' cases are among the three thousand taxpayer petitions pending in the Tax Court that raise the issue whether losses incurred on certain forward contracts with First Western Government Securities, Inc. ("First Western") may be claimed as deductions. (A2, A14).[3] These cases were assigned to Tax Court Judge Richard C. Wilbur, who established a "test case" procedure; ten cases (including petitioners') were selected for consolidated discovery, trial, briefing and decision. (A5, A15).[4] Trial commenced in late November 1984 but lasted only three weeks before Judge Wilbur fell ill.

The chief judge of the Tax Court directed Special Trial Judge Carleton Powell to begin presiding over the trial in December 1985, but his duties were limited to being an evidentiary referee; the proceedings were videotaped so that Judge

[2] Out of the 54,428 cases pending in the Tax Court on February 28, 1990, special trial judges had been assigned 8,781 small tax cases pursuant to 26 U.S.C. §§ 7443A(b)(2) & (3) and 14,500 complex so-called tax shelter cases pursuant to § 7443A(b)(4). (A73).

[3] Petitioners invoked the jurisdiction of the Tax Court pursuant to 26 U.S.C. § 6213.

[4] This case involves four of the test cases. Appeals from several of the other cases were taken to the Courts of Appeals for the Fourth and Sixth Circuits, see *Lewis* v. *Commissioner*, Fourth Cir. No. 89-2720; *Ames* v. *Commissioner*, Sixth Cir. No. 89-1695, but are now being settled.

Wilbur could view the evidence at home and prepare his findings and opinion upon recovery. (A5-6). In April 1986, Judge Wilbur's illness forced him to retire from the Tax Court. (A6, A72). In July 1986, the chief judge notified the parties that he would assign their cases to Special Trial Judge Powell for preparation of findings and an opinion to be submitted to Judge Wilbur, unless anyone objected to this assignment. (A6). Petitioners consented to this reassignment only on the express condition that the special trial judge's report be reviewed (and the case ultimately decided) by Judge Wilbur or by Chief Judge Sterrett himself. (A6).[5]

Special Trial Judge Powell issued detailed findings and an opinion on October 21, 1987, disallowing all of petitioners' investment loss deductions. A few hours later, Chief Judge Sterrett — who had heard none of the 16 weeks of complex financial testimony spanning three years of trial, nor reviewed the 9,000 pages of transcript and the 3,000 exhibits — adopted the special trial judge's report verbatim and entered it as the Tax Court's decision. (A6, A7).

Petitioners appealed the Tax Court decision to the Court of Appeals for the Fifth Circuit, arguing, *inter alia*, that the decision was invalid because the governing statute, 26 U.S.C. § 7443A, did not allow the Tax Court to assign this complex tax case to a special trial judge. The court below held that since this issue was "in essence, an attack upon the subject matter jurisdiction of the special trial judge, it may be raised for the first time on appeal." (A7). The court then brushed aside petitioners' arguments about the meaning of § 7443A(b)(4), holding that a special trial judge may lawfully be assigned not only minor tax cases but also "any other proceeding which the chief judge may designate," 26 U.S.C. § 7443A(b)(4), so

[5] One taxpayer objected to the reassignment altogether and that case was severed and is not at issue here.

long as the ultimate opinion is formally "issued by the Tax Court in the name of" a regular Tax Court judge. (A7).

Petitioners also argued that Special Trial Judge Powell had been appointed in violation of the Constitution by the chief judge of the Tax Court, who is neither a "Head[ ] of Department[ ]" nor a member of a "Court[ ] of Law" as required by the Appointments Clause, Art. II, § 2. The court below declined to reach the merits of this argument, holding that, "[b]y consenting to the assignment of their case at the time it was made, the Taxpayers waived this objection." (A8 n.9).

These same arguments were raised in the Tax Court in the related case of *Samuels, Kramer & Company* when the Tax Court likewise assigned that case to Special Trial Judge Powell. (A72-73).[6] Samuels, Kramer was the investment advisor for First Western, the firm with which the petitioners had their investment accounts. (A72). On April 9, 1990, the Tax Court held that it could constitutionally appoint special trial judges because it was a "Court[ ] of Law" within the meaning of the Appointments Clause. (A83-86). Aware of the significance of this controversial ruling, the Tax Court certified its order for interlocutory appeal (A89, 96) and the Court of Appeals for the Second Circuit granted Samuels' motion for leave to appeal.

Oral argument was held on October 24, 1990 and the case is now under submission before the Second Circuit. *Samuels, Kramer & Co.* v. *Commissioner*, Nos. 90-4060/90-4064. The Commissioner was represented by the Solicitor General of the United States, who argued that the chief judge of the Tax Court constitutionally wields appointment power as the "Head" an Executive "Department," but that the Tax Court certainly cannot be deemed a "Court of Law" within the meaning of the Appointments Clause. The opposing position of the Tax

[6] In the Tax Court the case was captioned *First Western Government Securities, Inc., et al.* v. *Commissioner*, 94 T.C. 32 (1990). This opinion is reprinted as Appendix C.

Court itself, that it is not an Executive Department but a "Court of Law," was presented by former Solicitor General Erwin Griswold, appearing as *amicus curiae*.[7]

REASONS FOR GRANTING THE WRIT

Petitioners argue *first*, that whatever the authority of a special trial judge to make narrow declaratory judgment rulings or to decide small tax claims, Congress never authorized such judges to function, as did the special trial judge here, in effect as full-blown surrogates for the Tax Court judges themselves. *See* Part I *infra*. *Second*, petitioners argue that, even if the governing statute does not bar the assignment and decision below, the Constitution does. For in order for the Tax Court to appoint "inferior Officers" such as special trial judges, it would have to be either a "Court[ ] of Law" or an Executive "Department" within the meaning of the Appointments Clause of the Constitution, Art. II, § 2, cl.2. But the Tax Court, which is an Article I or legislative court, is neither a "Department" nor a "Court of Law." *See* Part II *infra*.

This Court should grant certiorari to resolve these two questions for several reasons. *First*, these questions have great importance for the operation of the Tax Court. Special trial judges currently handle fully 42% of the Tax Court's docket. They handle not merely small tax claims, but also thousands of complex so-called "tax shelter" cases — at present over 14,500 such cases involving billions of dollars, constituting 26% of the Tax Court's total docket. This is so because in 1984, Congress amended 26 U.S.C. § 7443A by adding subsection (b)(4), which allows the Tax Court to assign a special

[7] Erwin Griswold, acting at the behest of the Tax Court, initially requested leave to appear as *amicus curiae* for the Tax Court judges themselves. However, the Office of the Solicitor General declined to consent to such formal separate representation for those federal officers, and thus Mr. Griswold appeared on his own behalf as *amicus curiae*.

trial judge to conduct and issue findings not only in small tax claims and other minor matters, but also in "any other proceeding which the chief judge may designate." (A100). Ever since then, the 14 special trial judges have assumed an ever-increasing share of the Tax Court's regular caseload — regardless of size, complexity or amount in controversy. This expansion of the special trial judges' authority constitutes an end-run around both the governing statute and the Appointments Clause.

The *second* reason to grant the writ is to resolve a fundamental constitutional question of grave importance to the structure of the federal government and to all who take their cases to the Tax Court: namely, whether the special trial judges who preside over nearly half the Tax Court's docket are officers appointed in violation of the Appointments Clause. So vexing is this constitutional issue that, while litigating this case and the related *Samuels, Kramer* case, the federal government has staked out a bewildering variety of positions on the constitutional status of the Tax Court under the Appointments Clause.

The government first contended before the Tax Court and the Fifth Circuit below that the Tax Court could be a "Court[ ] of Law" *or* an Executive "Department."[8] However, the Tax Division then confessed error, admitting that this constitutional analysis is "in tension" with the President's position that Article I tribunals such as the Tax Court may not wield appointment power under Art. II, § 2. (A102). *See also* A103.[9]

[8] *See* Commissioner's Objection to Petitioner's Motion for the Assignment of this Case to a Presidentially Appointed Tax Court Judge in *Samuels, Kramer & Co.* v. *Commissioner*, Tax Court No. 33758-84 at 15, 22; Brief for the Appellee Commissioner in *Freytag* v. *Commissioner*, Fifth Cir. No. 89-4436 at 48, 51 ("Govt.Br. in *Freytag*").

[9] As the government explained in a letter to the Fourth Circuit in a related case, the government's view on the constitutional status of the Tax Court "is not fully in accord with the view of the Government." *See* Letter from Shirley Peterson to Clerk of the Court for the Fourth Circuit, dated August 28, 1990. (Appendix H, A104).

Meanwhile, the Tax Court in *Samuels, Kramer* declined to be characterized as an Executive "Department" and held itself to be a "Court of Law" under the Appointments Clause. (A83-86).[10] Most recently, the Solicitor General argued to the Second Circuit in *Samuels, Kramer* that the Tax Court is definitely not a "Court of Law" but rather a "Department" within the Executive Branch. Solicitor General's Brief in *Samuels, Kramer & Co.* v. *Commissioner*, Second Cir. Nos. 90-4060, 90-4064 at 34. ("SG Br. in *Samuels, Kramer*").

Since the government cannot even make up its own mind on this constitutional question, this Appointments Clause issue should be settled by this Court. The constitutional issue was fully briefed and argued by the parties in the court below. But that court egregiously mistook this nonwaivable structural constitutional objection for a waivable personal right. This Court has not hesitated in other cases to reach and resolve thorny structural issues even where, unlike here, those issues were not even raised by the parties in the courts below. *See infra*, Part II E.

Petitioners are fully aware that there may well be mounting docket pressure at the Tax Court. But if the Tax Court requires additional manpower, the ready solution is for Congress openly to expand the number of presidentially appointed Tax Court judges (just as Congress periodically does with U.S. District Court judges) — *not* for the Tax Court to clone itself behind the scenes, with neither the careful scrutiny nor the public accountability that accompany appointment by the President. Alternatively, Congress could provide for the appointment of special trial judges in accord with the Appointments Clause,

[10] Although Mr. Griswold did not formally represent the Tax Court judges in opposing the Solicitor General in the Second Circuit, *see* note 7 *supra*, Mr. Griswold did present the position of the Tax Court and the government split its oral argument time between Solicitor General Starr and Mr. Griswold.

as it does with the magistrates and bankruptcy judges who are adjuncts to the Article III judiciary.

Certiorari should therefore be granted. At a minimum, this case should be held pending final resolution of the related *Samuels, Kramer* litigation in the Second Circuit and in this Court. That course would have two benefits: it would allow this Court to postpone consideration of the scope and constitutionality of § 7443A until a lower court gives thorough consideration to the merits of those questions, and it would avert the unfairness of possible inconsistent treatment of taxpayers in the Second and Fifth Circuits should the Second Circuit resolve these issues favorably to taxpayers while the Fifth Circuit plainly erred in deeming them waived.

I. THE DECISION BELOW DRASTICALLY EXPANDS THE JURISDICTION OF TAX COURT SPECIAL TRIAL JUDGES BEYOND THE SCOPE OF CONGRESSIONAL AUTHORIZATION.

The Tax Court and the court below have read 26 U.S.C. §7443A(b)(4) to allow the Tax Court to assign *any* proceeding to a special trial judge. This reading permits special trial judges to handle thousands of complex major tax cases — amounting to about 26% of the Tax Court's caseload and involving billions of dollars of alleged tax deficiencies. Whether Congress ever authorized this expansion therefore merits the plenary attention of this Court.

The Tax Court and the Fifth Circuit have misinterpreted § 7443A(b)(4) by reading it in isolation from adjoining provisions rather than in context. Section 7443A(b) empowers the chief judge of the Tax Court to assign certain narrow categories of minor tax cases to special trial judges for decision. Under § 7443A(b)(1), special trial judges may preside over and make the decision in declaratory judgment proceedings (involving

retirement plans, for example [11]) where the record has typically already been fully developed in the administrative process and hence the special trial judge will not conduct a full trial, resolve disputed factual issues, or tangle with a wealth of legal issues.[12] Special trial judges may also be assigned to decide small tax cases involving less than $10,000, § 7443A(b)(2) & (3), where very informal procedures are followed, legal issues are de-emphasized, evidentiary rules are relaxed,[13] and the special trial judge's decision will have absolutely no precedential value.[14] Thus § 7443A(b)'s enumeration limits the jurisdiction of special trial judges to cases in which the amount in controversy, the nature of the issues and the scope of the trial are insignificant and the potential precedential impact is nonexistent. *See, e.g., Page* v. *Commissioner*, 86 T.C. 1, 12-13 (1986).

Section 7443A(b)(4), added in 1984,[15] allows the Tax Court to assign "any other proceeding which the chief judge may designate" to be heard by a special trial judge, but that judge may not "make the decision of the court" in such a case. § 7443A(c). If taken literally, this expansive language would make the specific grants of authority in (b)(1), (2) and (3) superfluous — a result barred by elementary principles of statutory construction. *See Penn. Dept. of Public Welfare* v. *Davenport*, 110 S.Ct. 2126, 2133 (1990); *Mackey* v. *Lanier Collection Agency*, 108 S.Ct. 2182, 2189 (1988). The limits on the authority of special trial judges carefully delineated in §§ 7443A(b)(1) through (3) become meaningless if "any other proceeding" in (b)(4) is construed to permit a special trial judge to adjudicate

[11] *See* 26 U.S.C. § 7476.

[12] *See* M. Garbis, P. Junghans, S. Struntz, *Federal Tax Litigation: Civil Practice & Procedure* ¶21.02[1] (1985).

[13] *See id.* at ¶14.01.

[14] *See* 26 U.S.C. § 7463(b).

[15] *See* Deficit Reduction Act of 1984, Pub.L. No.98-369, § 463(a), 1984 U.S. Code Cong. & Admin. News (98 Stat.) 824.

and effectively decide cases such as the present "test" cases, involving billions of dollars, thousands of parties, complex facts and unsettled tax issues — subject only to a Tax Court judge's formal entry of that decision.

In *Gomez* v. *United States*, 109 S.Ct. 2237 (1989), this Court considered an expansive "catch-all" provision in the Federal Magistrates Act, 28 U.S.C. § 631, that is similar to the "any other proceeding" provision of § 7443A. Despite the broad language of the Magistrates Act, which permits magistrates to be assigned "such additional duties as are not inconsistent with the Constitution and laws of the United States," 28 U.S.C. § 636(b)(3), this Court unanimously held that magistrates could not conduct felony trial jury selection, because the catch-all provision had to be read in light of the earlier, specific grants of power. "Any additional duties performed pursuant to a general authorization in the statute reasonably should bear some relation to the specified duties." 109 S.Ct. at 2241. Therefore, "the carefully defined grant of authority to conduct trials of civil matters or in minor criminal cases should be construed as an implicit withholding of the authority to preside at a felony trial." *Id.* at 2245.

Here, as in *Gomez*, § 7443A(b)(1)-(3)'s narrow grant of power to special trial judges over declaratory judgment proceedings and minor tax cases limits the scope of (b)(4). It requires that (b)(4)'s statement that special trial judges may be assigned "any other proceeding" be construed to apply only to proceedings "reasonably . . . bear[ing] some relation" to those minor cases, *Gomez*, 109 S.Ct. at 2241, and not to complex, major tax cases such as this one. Congress deemed the addition of (b)(4) to be a "technical change," [16] and therefore it surely did not "contemplate inclusion," *Gomez*, 109 S.Ct.

[16] *See Joint Comm. on Taxation*, 98th Cong., 2d Sess., *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984* 760 (Joint Comm. Print).

at 2245, of major tax litigation among the other proceedings that a special trial judge may be assigned.

The court below ignored the canons of statutory interpretation reaffirmed in *Gomez* and held that a special trial judge could indeed be given power over any proceeding so long as the ultimate formal opinion "was issued by the Tax Court in the name of" a regular Tax Court judge. (A7). This resolution is wholly inadequate. *First*, it ignores the fact that a proper reading of the "any other proceeding" language of § 7443A does not even authorize a special trial judge to preside over a case such as this one, let alone *decide* it.

Second, under Tax Court practice, special trial judges routinely *make* the decision of the court, even if a full Tax Court judge formally enters it in the record. Special trial judges conduct trials and prepare findings of fact and conclusions of law. Tax Court Rule 183(b). (A91). Tax Court Rule 183(c) mandates that such factual findings "*shall be presumed to be correct*" by the Tax Court judge. (A92) (emphasis added); *see Stone* v. *Commissioner*, 865 F.2d 342, 345 (D.C.Cir. 1989). This presumption flatly precludes *de novo* review by the Tax Court. And the only circuit court decision addressing this precise issue has held that special trial judge factual findings are reviewable, at most, under a "clearly erroneous" standard. *Stone* v. *Commissioner*, 865 F.2d at 344-47.

This case is a perfect example of how special trial judges routinely do the Tax Court's work with only the most cursory supervision. Findings of fact often conclusively decide tax litigation, as they did in this case, because whether a particular transaction and the deduction claimed for it will be disallowed as "a sham is," as the court below held, "a question of fact reviewed under the clearly erroneous standard." (A8). Thus Special Trial Judge Powell's conclusion that petitioners' deductions were "shams" and that back taxes were therefore owed was virtually binding on the Tax Court. That conclusion was reached

after a trial that took place over three years, involved 16 weeks of complex expert and financial testimony, generated 9,000 pages of transcript and 3,000 exhibits. Yet the Tax Court's chief judge rubber-stamped the special trial judge's findings and opinion just a few hours after receiving them without reviewing the evidence or changing a single word, thereby deciding test cases that may determine the fate of over 3,000 other tax cases involving billions of dollars.[17]

The court below virtually conceded that the Tax Court review in this case was but a rubber stamp, noting explicitly the "short time span" (A8) — a few brief hours — in which the supposed review of the 9,000 page transcript and 3,000 exhibits was accomplished. For the court below to treat this as meaningful review is truly an arid exercise in empty formalism. Although allowing special trial judges to resolve minor tax matters may comport with the congressional design, the assignment of this complex and far-reaching case to a special trial judge for effectively final resolution is inconsistent with the narrow grant of authority in § 7443A. Because this issue affects thousands of complex major tax cases handled by special trial judges — amounting to about 26% of the Tax Court's caseload — it merits the plenary attention of this Court.

[17] This legally mandated deference to the special trial judge was particularly inappropriate in this case because the special trial judge was absent from significant portions of this trial. Since he was assigned this case only after Tax Court Judge Wilbur became ill, Special Trial Judge Powell did not hear the first four weeks of trial, which included expert testimony on the fundamental nature of the underlying transactions as well as the testimony of petitioners, their financial advisors, the president of the investment company, its operations managers, its accountants, and its director of computer operations. Under Tax Court Rule 183(c), findings are "presumed to be correct" on the assumption that the special trial judge "had the opportunity to evaluate the credibility of witnesses." (A92). But here Judge Powell's findings were presumed correct even though he never heard or saw much of the most important testimony.

II. THE DECISION BELOW PERMITS THE APPOINTMENT OF SPECIAL TRIAL JUDGES BY THE CHIEF JUDGE OF THE TAX COURT, IN VIOLATION OF THE APPOINTMENTS CLAUSE.

If § 7443A(b)(4) is read, as it was below, to permit a special trial judge to preside over the trial of *any* Tax Court case, then there is no way of avoiding the question whether the Article I Tax Court is, within the meaning of the Appointments Clause, a "Court[ ] of Law" or whether its chief judge is a "Head[ ] of Department" in which Congress may constitutionally repose appointment power.

This issue is a narrow one; petitioners do not challenge the constitutionality of Article I or so-called "legislative courts." *Contrast CFTC* v. *Schor*, 478 U.S. 833 (1986); *Northern Pipeline Construction Co.* v. *Marathon Pipe Line Co.*, 458 U.S. 50 (1982) ("*Marathon*"). The question presented is not whether such tribunals may exercise some federal judicial or adjudicatory power in accord with Article III of the Constitution, but whether they may exercise appointment power in accord with Article II, § 2. Petitioners do not challenge the Tax Court's jurisdiction to conduct and decide tax cases, only its power to appoint inferior officers to perform those functions for it. The power to adjudicate issues of federal law is distinct from the power to appoint federal officers, and the appointment power does not automatically follow the power to adjudicate. Perhaps adjudicative power may be dispersed throughout the federal government without running afoul of Article III, but the power to appoint is narrowly limited by Article II, § 2.

A. A Special Trial Judge Is An "Inferior Officer" Whose Appointment Must Conform To The Appointments Clause.

The Appointments Clause, Article II, § 2 of the Constitution, governs the appointment of "all persons who can be said to hold an office under the government." *Buckley* v. *Valeo*, 424 U.S. 1, 125 (1976). As the United States Tax Court held in the related *Samuels, Kramer* case, its own special trial judges are indeed inferior officers of the United States, not mere employees. (A79-80). That holding cannot plausibly be contested.

A special trial judge plainly fits this Court's contemporary definition of an "officer" for Appointments Clause purposes, namely, an "appointee exercising significant authority pursuant to the laws of the United States," *Buckley*, 424 U.S. at 126.[18] He may rule on all pretrial and trial motions without any review by the Tax Court. Tax Court Rule 181. He may compel the production of evidence, swear witnesses, issue subpoenas and "exercise such further and incidental authority . . . as may be necessary for the conduct of trials or other proceedings." *Id.* As interpreted below (A7) and by the Tax Court itself (A76-78), 26 U.S.C. § 7443A allows a special trial judge to preside over *any* Tax Court case, to formally enter the decision in many minor tax matters, and to issue findings and opinions that may be adopted verbatim by the Tax Court without meaningful review even in the most complex and significant cases, as they

[18] Holding a Tax Court special trial judge to be an "inferior Officer" also comports with the venerable definition of "officer" formulated by Chief Justice Marshall for purposes of construing the Appointments Clause in *United States* v. *Maurice*, 26 Fed.Cas. 1211, 1214 (No.15,747) (1823): an officer is one who performs duties that are continuing and that are defined by laws or rules prescribed by government rather than by contract. *See also Burnap* v. *United States*, 252 U.S. 512, 517-20 (1920). The office of special trial judge is created by statute and the duties of the office are spelled out in statute and Tax Court rules. See 26 U.S.C. § 7443A (A100); Tax Court Rules 180-83.

were here. *See supra* Part I. As demonstrated above, the special trial judges do a substantial portion of the Tax Court's work and exercise virtually the same powers as presidentially-appointed Tax Court judges. Accordingly, they are "Officers."[19]

B. The Tax Court Is Not A "Court Of Law" Within The Meaning Of The Appointments Clause.

The power to appoint inferior officers may be reposed by Congress in the President with the advice and consent of the Senate, "in the President alone, in the Courts of Law, or in the Heads of Departments." Art. II, § 2. (A99). The fact that the Tax Court may be a legitimate Article I court does not *ipso facto* make it a "Court of Law" within the meaning of the Appointments Clause. That clause must be read in the context of the entire Constitution. As the Solicitor General of the United States formally conceded in the related *Samuels, Kramer* case, an Article I court cannot be a "Court of Law" for Appointments Clause purposes, because "the Framers used the term '*the* Courts of Law' in the Clause to refer to those courts created and existing under Article III as part of the Judicial Branch." (SG Br. in *Samuels, Kramer* at 42 (emphasis by the government).)[20]

[19] Special trial judges in the Tax Court are at least at the same level as federal magistrates in the Article III district courts, who are deemed inferior officers whose appointment (by the Article III judiciary) must comport with the Appointments Clause. *Pacemaker Diagnostic Clinic* v. *Instromedix*, 725 F.2d 537, 545 (9th Cir.) (en banc), *cert. denied*, 469 U.S. 824 (1984). Indeed, special trial judges enjoy greater power under federal law than do magistrates, since their trial rulings are unreviewed and even their ultimate findings and opinions are presumed correct. In contrast, magistrates may preside over a civil trial only with the consent of the parties, 28 U.S.C. § 636(c)(1), and their rulings on dispositive motions, their findings of fact and their conclusions of law are all subject to *de novo* review if any party files objections. *See, e.g., LoConte* v. *Dugger*, 847 F.2d 745, 750 (11th Cir.), *cert. denied*, 109 S.Ct. 397 (1988).

[20] The Constitution repeats many legal terms of art in its different provisions, and they are naturally understood to mean the same things each time. For example, the "Bill of Attainder," "ex post facto Law" and "Title of Nobility"

Understanding the Framers to have meant "Courts" in the Appointments Clause to denote the same institutions they described as "Courts" in Art. III, § 1, is not only the most natural reading of the Constitution's text, but also the reading recently suggested by this Court. In *Buckley* v. *Valeo*, this Court held that the Appointments Clause must be read in light of Article III's grant of judicial power to the federal "Courts." After reciting the Constitution's three great grants of Legislative, Executive and Judicial power, including Art. III, § 1's declaration that "[t]he judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish," the Court squarely held that "[i]t is in the context of these cognate provisions of the document that we must examine the language of Art. II, § 2, cl. 2." 424 U.S. at 124. When this Court restated the command of the Appointments Clause in *Buckley*, the terms it chose were significant: "Inferior officers Congress may allow to be appointed by the President alone, by the heads of departments, or by *the Judiciary*." 424 U.S. at 132 (emphasis added). The term "Judiciary" has always been understood to refer exclusively to those judges appointed in accord with Article III. *See, e.g. id.*; *Marathon*, 458 U.S. at 70 n.25.

Although the Tax Court is undeniably an adjudicative forum, not all "courts" are created equal under the Appointments Clause. The Tax Court is not a "Court of Law" — "[i]t has no jurisdiction to exercise the broad common law concept of 'judicial power' vested in courts of general jurisdiction . . . ." *Burns, Stix Friedman & Co.* v. *Commissioner*, 57 T.C. 392, 396 (1971). It is rather a "public rights" tribunal that adjudicates matters "arising 'between the Government and persons subject to its authority in connection with the performance of the con-

mentioned in Art. I, § 9 are the same as the Bill, Law and Title denoted by those same terms in Art. I, 10. Article III courts are the only "Courts" mentioned by name in the Constitution.

stitutional functions of the executive or legislative departments.'" *Marathon*, 458 U.S. at 67-68 (quoting *Crowell* v. *Benson*, 285 U.S. 22, 50 (1932)). As such, the Tax Court is empowered to decide cases "where the Government is involved in its sovereign capacity," *Granfinanciera, S.A.* v. *Nordberg*, 109 S.Ct. 2782, 2795 (1989), when taxation and tax disputes are at stake. *Marathon*, 458 U.S. at 69 n.22; *Crowell*, 285 U.S. at 51. This Court's consistent distinction between "public rights" tribunals "'with special competence in the relevant field'" and "'a federal court of law'" of plenary jurisdiction, *Nordberg*, 109 S.Ct. at 2795 & n.9 (quoting *Atlas Roofing Co.* v. *Occupational Safety and Health Review Comm'n*, 430 U.S. 442, 455 (1977)), buttresses the proposition that the Tax Court is not a "Court of Law" within the meaning of the Appointments Clause.[21]

Thus, as the Solicitor General argued vigorously in the related *Samuels, Kramer* case, the Appointments Clause's reference to "Courts of Law" restricts the power of appointment within the federal government to Article III common law courts of plenary jurisdiction, and should therefore be understood to exclude specialized Article I legislative courts.[22]

[21] Any comparison to the territorial courts and their congressional grants of power to appoint officers would be wholly inapposite. For the Constitution does not require that the separation of the branches mandated at the federal level, "where laws of national applicability and affairs of national concern are at stake," be replicated at the level of territorial and District of Columbia governments. *Palmore* v. *United States*, 411 U.S. 389, 407-08 (1973) (federal separation of powers "give[s] way to accommodate plenary grants of power to Congress to legislate with respect to specialized [geographic] areas"). *See also O'Donoghue* v. *United States*, 289 U.S. 516, 545-48 (1933) (courts in District of Columbia may mingle Art. III power with non-judicial administrative and executive functions); *Glidden* v. *Zdanok*, 370 U.S. 530, 545-46 (1962) ("the freedom of the territories to dispense with protections deemed inherent in a separation of governmental powers was . . . fully recognized").

[22] The plainly contrary language of the Appointments Clause notwithstanding, the Tax Court held in the related *Samuels, Kramer* case that Congress may vest federal appointment power in any "lawfully created government body" even if that body does "not fit within the terms 'Heads of Departments' or 'Courts of Law.'" (A86). This notion of "anything goes" cannot be reconciled with the Constitution.

C. The Chief Judge Of The Tax Court Is Not A "Head Of Department" Within The Meaning Of The Appointments Clause.

Abandoning the position it took before the Tax Court and the Fifth Circuit, that "the Tax Court clearly qualifies as a court of law" within the meaning of the Appointments Clause, Govt.Br. in *Freytag* at 47, the government confessed error a few months later in the related *Samuels, Kramer* case in the Second Circuit and argued that the "Tax Court is a 'Department[ ]' (rather than 'Court[ ] of Law') within the meaning of the Appointments Clause and its chief judge, as the 'Head' of that 'Department,' is entitled to appoint inferior Officers." SG Br. in *Samuels, Kramer* at 34. The only ground the government could offer for treating the Tax Court as an executive agency and its chief judge as an executive officer was what it admitted was a "process of elimination": the Tax Court obviously isn't a part of the Legislative Branch, nor is it a "Court of Law," so it must be a "Department" in the Executive. *Id.* at 43-44, 48.[23] This is an *ipse dixit*, not an argument, and it is at odds with 130 years of constitutional exegesis and with the legislative history surrounding the creation of the Tax Court.

The Departments of the United States Government are identified by statute and do not include the Tax Court.[24] In *United States* v. *Germaine*, 99 U.S. 508 (1879), this Court rejected an argument that the Commissioner of Pensions was the head of a "Department" under the Appointments Clause, holding that term limited to those "'part[s] or division[s] of executive government, as the Department of State, or of the Treasury,'" expressly created and given "the name of a department" by Congress. *Id.* at 510-11. *See also id.* at 511 (term does not include commissioners or bureau officers); *Burnap* v. *United States*, 252 U.S. 512, 516 (1920) (term refers to "member[s] of the Cabinet," "not . . . heads of bureaus or lesser divisions"); *United States* v. *Mitchell*, 89 F.2d 805, 808 (D.C.Cir. 1937) (head of an "independent board or commission created by Act of Congress" is not a "head of department").[25] This construction of the term "Department" as denoting what Justice Brandeis called the "great division[s] of the executive branch," *Burnap*, 252 U.S. at 516, has also been consistently endorsed for over 130 years by the United States Attorneys General.[26]

Any procrustean attempt to stuff the Tax Court into the category of Executive "Department" would also conflict with the legislative history of the Tax Court itself. Far from designating the Tax Court an Executive "Department," in 1969 Congress expressly established the Tax Court as an "Article I" legislative "court"[27] with what the government concedes in

[23] The Tax Court's amicus before the Second Circuit, former Solicitor General Erwin Griswold, sharply criticized the argument that the Tax Court was a department within the Executive Branch. *See* Brief for *Amicus Curiae* in *Samuels, Kramer & Co.* v. *Commissioner* at 4-5, 31.

[24] *See* 5 U.S.C. § 101 (Executive "Department[s]" are: State, Treasury, Defense, Justice, Interior, Agriculture, Commerce, Labor, Health and Human Services, Housing and Urban Development, Transportation, Energy, Education and Veterans Affairs).

[25] Significantly, two of the Departments — Energy and Veterans Affairs — have been added by Congress since 1969, the year Congress changed the status of the Tax Court to an Article I court. *See* Pub.L. 100-527, § 13(b), 102 Stat. 2643 (1988); Pub.L. 95-91, Title VII, § 710(a), 91 Stat. 609 (1977). Had Congress meant to create the Tax Court as a Department, it surely would have amended 5 U.S.C. § 101, as it has every other time it has added a new Department to the executive branch or elevated a pre-existing executive entity (*e.g.*, the Bureau of Veterans Affairs, or the various sub-cabinet bureaus and departments that were consolidated into the Department of Energy).

[26] *See, e.g.*, 26 Op.Atty. Gen. 209, 211-212 (1907) (term does not include bureaus, agencies or other offices, only those "immediate superior ministerial" offices under the President designated as Departments by Congress); 11 Op.Atty. Gen. 209 (1865); 6 Op.Atty.Gen. 326, 327, 332-33, 344 (1854).

[27] Section 951 of the Tax Reform Act of 1969, Pub.L.No. 91-172, 83 Stat. 487, codified at 26 U.S.C. § 7441, provided that the Tax Court was "a court of record" established "under Article I of the Constitution." The Tax Court's predecessor, the Board of Tax Appeals, was an Executive Branch adjudicative agency. *See generally* H.Dubroff, *The United States Tax Court: An Historical Analysis* (1979). Even when deemed part of the Executive Branch, the Tax Court's predecessor was expressly designated a mere "independent agency" rather than a "Department." *See* Internal Revenue Code of 1939, 26 U.S.C. § 1100.

Samuels, Kramer was the express purpose "to distance the Tax Court from the Executive Branch," SG Br. in *Samuels, Kramer* at 46 n.37, and to remove it from Executive control. Surely a federal court may not override Congress' considered judgment and redesignate as an Executive "Department" an entity that Congress saw fit to remove from Executive control and to constitute as an Article I legislative court.[28]

D. Reading The Appointments Clause To Preclude Tax Court Appointment Of Special Trial Judges Does Not Threaten The Administrative State.

Granting the relief petitioners seek would have great importance for the operation of the Tax Court and the principle of separation of powers embodied in the Appointments Clause, but would impose virtually no inconvenience upon the federal government. *First*, there need be no concern that the relief petitioners seek might cripple the Tax Court, for the constitutional flaw here could be easily remedied. Upon invalidation of the current method of appointing special trial judges, Congress could simply expand the Tax Court to include additional judges to be appointed in accord with the Appointments Clause as are the current Tax Court judges. This was the route Congress chose when it took it upon itself to change the Claims

[28] The legislation makes plain Congress' intent to strip the Tax Court even of its previous identity as a mere "executive agency," rather than to elevate it to the level of a full Executive "Department." Staff of the Joint Committee on Internal Revenue Taxation, 91st Cong., 2d Sess., *General Explanation of the Tax Reform Act of 1969* 262-63 (Joint Committee Print 1970). "Since the Tax Court had only judicial duties, Congress believed it anomalous to continue to classify it with quasi-judicial executive agencies that have rule-making and investigatory functions." *Id.* at 262. Furthermore, under Art. II, § 2, the President "may require the Opinion, in writing, of the principal officer in each of the executive Departments," yet one of the reasons for transforming the Tax Court into an Article I tribunal was to eliminate the need for the Court to respond to Executive inquiries pertaining to executive supervisory or budgetary authorities, a task that was cumbersome and often irrelevant to the Tax Court's adjudicative duties. *See* Dubroff, *supra*, at 190 & n.177.

Court from an Article III to an Article I tribunal in 1982.[29] Or the special trial judges could be appointed as inferior officers by "the President alone." Art. II, § 2. Either resolution would be practicable and, more importantly, consistent with the narrow scope and most natural reading of the Appointments Clause.

Second, this case poses no challenge whatsoever to the existence of the so-called "fourth branch" of the federal government. There is no issue here of the legitimacy of Article I courts, Executive agencies, or independent agencies and commissions.

Third, the reading of the Appointments Clause urged by petitioners poses no significant disruption to the way in which seemingly similar positions elsewhere in the federal government are filled, because virtually all other adjudicatory officers and agents in the federal government are distinct from Tax Court special trial judges and would therefore be unaffected by a decision in this case.

The appointment power of the Article III judiciary (who are undoubtedly "Courts of Law") is unquestioned; so, for example, federal magistrates, bankruptcy judges and Article III special masters are unaffected by petitioners' argument. *See* 28 U.S.C. §§ 152, 631(a); *Ex Parte Peterson*, 253 U.S. 300, 312-14 (1920). The appointment power that the Heads of the Executive Departments may wield pursuant to congressional grant is likewise unquestioned.

Executive branch subcabinet agencies, commissions and independent agencies would similarly be untouched by the result petitioners urge. The adjudicatory agents in these organs of government are administrative law judges ("ALJs") who are

[29] See Pub.L. 97-164, Title I, § 121(b), 96 Stat. 34 (April 2, 1982). The offices of the fifteen Claims Court commissioners (appointed by the Claims Court when it was an Article III tribunal) were eliminated. But the Court itself was expanded from seven to sixteen judges to compensate for the increased workload. *See also* 28 U.S.C. § 171.

part of the competitive civil service and are expressly and aptly designated "employees," rather than "inferior officers," by the relevant legislation and rules.[30] Other agency appointees are likewise employees, such as, for example, the "officers, attorneys, examiners, and other experts" whom the Securities and Exchange Commission is "authorized to appoint and fix the compensation of," often "subject to the civil-service laws." 15 U.S.C. § 78d(b). None of the personnel these agencies and commissions "appoint" are "officers" within the meaning of the Appointments Clause, because their positions, duties, functions and compensation are left up to the agencies rather than "established by law." [31] In contrast, the position of special trial judge is explicitly created by statute and the jurisdiction, duties, compensation and even the travel expense allowances appurtenant to the office are carefully defined by Congress. 26 U.S.C. § 7443A (A100). Moreover, special trial judges enjoy sweeping, effectively unreviewed adjudicative power in many categories of cases and, in the § 7443A(b)(4) category at issue here, in practice exercise power virtually coextensive with that held by Tax Court Judges themselves.

The only effect petitioners' argument could have is on other statutorily authorized and defined officers appointed by Article I courts. The only example of which petitioners are aware is

[30] The Administrative Procedure Act expressly denominates the ALJs "presiding *employees*." 5 U.S.C. §§ 554(d), 556(b) & (c), 557(b) (emphasis added). *See also* 5 C.F.R. § 930.201(b) (ALJ is a competitive civil service position). ALJs take competitive exams, 5 U.S.C. § 1104(a)(2); are paid according to civil service pay scales, 5 U.S.C. §§ 5335(a)(B), 5372; and are hired, fired, and transferred among agencies pursuant not to the whims of the agency and commission heads but to the regulations and authority of the Office of Personnel Management, 5 U.S.C. §§ 1305, 3344, 7521; 5 C.F.R. § 930.203a(a).

[31] *See, e.g., United States* v. *Maurice*, 26 Fed.Cas. at 1214-15 (statute directing Secretary of War to prepare regulations defining duties and powers of enumerated personnel "cannot be construed to extend to the establishment of offices"); *Burnap* v. *United States*, 252 U.S. at 516; *Auffmordt* v. *Hedden*, 137 U.S. 310, 327 (1890) (employees are "lesser functionaries subordinate to officers of the United States").

an inferior officer that the Executive Branch itself has already identified as having been appointed in violation of the Appointments Clause. This is a recently created group of special masters in the United States Claims Court, now an Article I court, charged with jurisdiction over claims arising under the National Vaccine Injury Compensation Program. 42 U.S.C. §§ 300aa-11, 300aa-12(a). These masters are appointed by the Claims Court, § 300aa-12(c)(1), and their tenure, compensation, jurisdiction and duties — like that of Tax Court special trial judges — are carefully defined by statute. *See* § 300aa-12. The special masters' proposed findings of fact and conclusions of law must be presumed correct by the Claims Court and may be set aside only if arbitrary or capricious. § 300aa-12(e)(2)(B); *Hanagan* v. *Secretary*, 19 Cl.Ct. 7, 15-16 (1989).

The vaccine special masters, like Tax Court special trial judges, are inferior officers of the United States whose method of appointment violates Article II, § 2 because the Claims Court, like the Tax Court, is neither a "Department" nor a "Court of Law." As the President himself noted upon signing the bill creating the vaccine masters, the bill "vest[s] significant authority pursuant to the laws of the United States in persons whose appointment and removal are inconsistent with the requirements of Article II . . . ." [32] The President directed the Attorney General and the Secretary of Health and Human Services to submit legislation to correct the problem. (A103). It is worth emphasizing that the Justice Department has admitted that its analysis of the Appointments Clause in the Fifth Circuit below cannot be reconciled with this formal statement by the President that Article I tribunals such as the Tax Court cannot wield appointment power under Art. II, § 2. (*See* A102-03).

[32] Statement of the President on Signing the Omnibus Budget Reconciliation Act of 1989, 25 Weekly Comp. of Pres. Docs. 1970-1 (Dec. 19, 1989). Pertinent portions of the statement are reprinted in Appendix G. (A103).

Thus the extent of the change that petitioners' reading of the Appointment Clause would have on the federal government is meager.

E. This Constitutional Objection Cannot Be And Has Not Been Waived.

Although the Appointments Clause issue was briefed and argued by both parties below, the Fifth Circuit declined to reach the merits of the argument, dismissing it with the observation that, "[b]y consenting to the assignment of their case at the time it was made, the Taxpayers waived this objection." (A.8 n.9). This ruling is plainly incorrect.[33]

1. An argument premised on the Constitution's structural separation of powers is not a matter of personal rights and therefore is not waivable.

This Court has consistently held that objections to judicial procedure based on the Constitution's structural provisions, such as the Appointments Clause, cannot be waived, in contrast to assertions of personal rights under the Constitution. The court below committed plain error by confusing these two categories. A constitutional provision safeguarding a "personal right," such as "Article III's guarantee of an impartial and independent federal adjudication[,] is subject to waiver, just as are other personal constitutional rights that dictate the procedures by which civil and criminal matters must be tried." *CFTC* v. *Schor*, 478 U.S. 833, 848-49 (1986). But if a provision "also serves as 'an inseparable element of the constitutional system of checks and balances,'" it cannot be waived.

[33] Moreover, this ruling is flatly inconsistent with the Fifth Circuit's simultaneous decision to reach and decide petitioners' statutory argument that the special trial judge could not be assigned this case — an argument that, by the court's own reasoning, should likewise have been "waived" by consent to the assignment to the special trial judge if such objections are indeed waivable. (A7).

Id. at 850. *See also Pacemaker Diagnostic Clinic* v. *Instromedix*, 725 F.2d at 543-44 ("The component of the separation of powers rule that protects the integrity of the constitutional structure, as distinct from the component that protects the rights of the litigants, cannot be waived by the parties"). When a

> structural principle is implicated in a given case, the parties cannot by consent cure the constitutional difficulty for the same reason that the parties by consent cannot confer on federal courts subject matter jurisdiction beyond the limits imposed by Article III, § 2. . . . [N]otions of consent and waiver cannot be dispositive because the limitations serve institutional interests that the parties cannot be expected to protect.

CFTC v. *Schor*, 478 U.S. at 850-51.[34] Indeed, such objections will be heard and decided even when — unlike the present case — there is evidence that the objecting party deliberately delayed raising the issue until the case was decided against him.[35]

[34] Accordingly, this Court reached and decided the structural Article III issue in *Schor* even though "Schor indisputably waived any right he may have possessed" to an Article III tribunal by "expressly demand[ing]" that the case proceed before the CFTC. 478 U.S. at 849.

[35] Schor's structural objection based on the separation of powers was deemed unwaivable even in the face of abuse by the party. As this Court noted, Schor "was content to have the entire dispute settled in the forum he had selected until the ALJ ruled against him on all counts; it was only after the ALJ rendered a decision to which he objected that Schor raised any challenge to the CFTC's consideration of [his opponent's] counterclaim." 478 U.S. at 849. *See also Glidden* v. *Zdanok*, 370 U.S. 530, 535-36 (1962) (usual rule "preventing litigants from abiding the outcome of a lawsuit and then overturning it if adverse upon a technicality of which they were previously aware" does "not obtain" when the defect is "jurisdictional" or "is based upon nonfrivolous constitutional grounds").

This case parallels the circumstances in *Pacemaker Diagnostic Clinic* v. *Instromedix*, where a party challenged a magistrate's power to preside over a civil trial and enter the final judgment, despite that party's formal consent to the procedure. In reaching the merits of the constitutional challenge, Judge (now Justice) Kennedy wrote for the *en banc* court that "[s]tatutes or governmental actions which violate the separation of powers doctrine in its systemic aspect should be invalidated, as a general rule, despite waiver by affected private parties." 725 F.2d at 544. The Appointments Clause objection raised by petitioners here is an equally fundamental part of the Constitution's structure and likewise cannot be waived. Indeed, in *Glidden* v. *Zdanok*, this Court expressly included Appointments Clause objections to judicial officers in the category of structural constitutional objections that cannot be waived:

> [I]n *Lamar* v. *United States*, 241 U.S. 103, 117-18, the claim that an intercircuit assignment . . . usurped the presidential appointing power under Art. II, § 2, was heard here and determined upon its merits, despite the fact that it had not been raised in the District Court or in the Court of Appeals or even in this Court until the filing of a supplemental brief upon a second request for review.

370 U.S. at 536.[36]

[36] The government argued below that *Glidden* is inapposite because the judges whose appointments were challenged there had either "cast the deciding vote" in an appeal or had "entered the judgment of conviction." Govt. Brief in *Freytag* at 37 n.33. The supposed distinction is without merit. The special trial judge in this case presided over 75% of the trial and wrote the findings and opinion that were "presumed correct" and summarily adopted verbatim by the Tax Court. As this Court has unanimously recognized, litigants are entitled to have "all critical stages" of their judicial proceedings "conducted by a person with jurisdiction to preside." *Gomez* v. *United States*, 109 S.Ct. at 2248.

2. Even if this objection were waivable, there was no uncoerced consent to the special trial judge's authority in this case.

In any event, petitioners' acceptance of the assignment of a special trial judge to complete the trial in this case cannot, under the circumstances, be deemed free and voluntary consent. Even if the Appointments Clause were not a structural element of the Constitution and conferred purely personal rights, it remains the law that a "waiver of personal rights must, of course, be freely and voluntarily undertaken." *Pacemaker*, 725 F.2d at 543. As Judge Kennedy explained in that case, which involved the issue of a magistrate's authority to conduct a civil trial with the parties' consent:

> The purported waiver of the right to an Article III trial would not be an acceptable ground for avoiding the constitutional question if the alternative to the waiver were the imposition of serious burdens and costs on the litigant. If it were shown that the choice is between trial to a magistrate or the endurance of delay or other measurable hardships not clearly justified by the needs of judicial administration, we would be required to consider whether the right to an Article III forum had been voluntarily relinquished.

725 F.2d at 543.

Petitioners were plainly faced with just such a Hobson's choice here. Petitioners began the trial in this case before a duly-appointed Tax Court judge (Judge Wilbur, whose jurisdiction they have never questioned) and originally consented only to allow a special trial judge to act as an evidentiary referee in the courtroom while the ailing Judge Wilbur viewed the videotapes at home and remained in charge of the case. When

Judge Wilbur took a disability retirement from the Tax Court, the petitioners had been wrestling with the trial for 16 months and had no meaningful choice but to allow the special trial judge to take charge of the case and prepare findings and an opinion. The alternative was to start all over again and simply scrap a trial that had already generated thousands of pages of transcript, hundreds of hours of videotape and numerous exhibits, and that had already consumed hundreds of thousands of dollars in costs and attorneys fees. The "imposition of [these] serious burdens and costs on the litigant" makes petitioners' decision to proceed before the special trial judge involuntary and lacking in consent. *Pacemaker*, 725 F.2d at 543.[37]

CONCLUSION

The statutory and constitutional questions presented by this case have enormous implications for the operation of the Tax Court and thousands of its pending cases. These questions have also generated extraordinary confusion within the govern-

[37] Nor can petitioners be said to have voluntarily relinquished their rights to trial before a constitutionally appointed judicial officer by taking their cases to the Tax Court. *First*, they consented to have their cases resolved by legitimate Tax Court judges, not by a special trial judge assigned in violation of the governing statute and appointed in violation of the Appointments Clause. At least with respect to the statutory argument, the court below agreed that the objection goes to subject matter jurisdiction and is therefore unwaivable. (A7); *see* note 33, *supra*. *Second*, if it were the law that one waived any constitutional objection to Tax Court procedures simply by filing a petition with that tribunal, then *all* plaintiffs in *all* fora could be said to have "waived" *any* constitutional or jurisdictional objections by virtue of their decision to litigate. But the law is otherwise. However sweeping the congressional power to "prescribe the conditions on which it will subject" the government to suit, *Cheatham* v. *United States*, 92 U.S. 85, 89 (1876), Congress cannot prescribe conditions that violate a *structural* constitutional provision such as the Appointments Clause. *See Buckley* v. *Valeo*, 424 U.S. 1, 133 (1976) (plenary authority of Congress over election practices does not give Congress leave to employ that authority in a manner that transgresses "well-established constitutional restrictions stemming from the separation of powers").

ment itself over the constitutional status of Article I courts under the Appointments Clause. These issues merit the plenary attention of this Court. That the constitutional issue was not addressed on the merits by the court below need not stand in the way. As Justice Harlan once wrote for this Court, even "the disruption to sound appellate process entailed by entertaining objections *not* raised below" is "plainly insufficient to overcome the strong interest of the federal judiciary in maintaining the constitutional plan of separation of powers." *Glidden* v. *Zdanok*, 370 U.S. at 536 (emphasis added). It is far more appropriate to reach and decide such an issue where, as here, the petitioners *did* raise and brief it below, only to have the court below invoke spurious reasons for refusing to reach it. Therefore, a writ should be granted.

In the alternative, this case should be held pending final resolution in this Court of these same issues in the related *Samuels, Kramer* litigation, which is currently under submission in the Second Circuit.

Respectfully submitted,

KATHLEEN M. SULLIVAN
Counsel of Record
BRIAN STUART KOUKOUTCHOS
1525 Massachusetts Avenue
Cambridge, Massachusetts 02138
(617) 495-4633

RICHARD J. SIDEMAN
MARTHA A. BOERSCH
SIDEMAN & BANCROFT
One Embarcadero Center
Suite 860
San Francisco, California 94111
(415) 392-1960
Counsel for Petitioners

November 13, 1990

TABLE OF CONTENTS

APPENDIX A.

Thomas L. FREYTAG and Sharon N. Freytag, Petitioners-Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellee.

Joe D. WOMBLE and Gladys E. Womble, Petitioners-Appellants,

v

COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellee.

Bert C. TIMM and Mildred H. Timm, Petitioners-Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellee.

Kenneth G. McCOIN and Candace G. McCoin, Petitioners-Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellee.

Nos. 89-4436, 89-4439, 89-4440 and 89-4450.

United States Court of Appeals,
Fifth Circuit

July 6, 1990

Appeals from the Decision of the United States Tax Court.

Before GEE, POLITZ, and JONES, Circuit Judges.

POLITZ, Circuit Judge:

Thomas and Sharon Freytag, Joe and Gladys Womble, Bert and Mildred Timm, and Kenneth and Candace McCoin (Taxpayers) appeal adverse deficiency determinations made against them by the Tax Court. The court disallowed the Taxpayers' deductions for losses allegedly incurred as the result of investments in a commodity straddle program on the grounds that the program was composed of sham transactions or, alternatively, that the Taxpayers did not enter into these transactions primarily for economic profit. Finding error of neither law nor fact, we affirm.

Background

The Taxpayers are four of approximately 3,000 taxpayers who have sought redetermination of deficiencies assessed against them for deducting losses allegedly realized from investments in straddles in forward contracts to buy and sell securities issued by the Government National Mortgage Association (GNMAs) and the Federal Home Loan Mortgage Corporation (FMACs).[1] The straddle portfolios in which the Taxpayers invested were all part of a computer-generated investment program offered by First Western Government Securities

[1] In a forward contract, as in a futures contract, an investor agrees to purchase (a long position) or sell (a short position) an underlying security on a specific date. A straddle investor holds an equal number of long and short positions in the same underlying security—the "legs" of the straddle. In theory, a straddle results in both tax deferral and conversion of ordinary income into capital gain by enabling an investor to close out one leg at a loss and offset this loss against ordinary income, while holding the gain leg open until a later year.

(First Western), formed in 1978 by Sidney Samuels, an attorney and former Internal Revenue Service agent.[2]

We summarize the findings of the Tax Court, detailed in its exhaustive opinion, ***Freytag v. Commissioner***, 89 T.C. 849 (1987), as follows: First Western identified prospective investors by using accountants, lawyers, and financial consultants it referred to as "finders." All First Western investors signed a customer agreement stating that First Western

> may without demand for margin, whenever in [its] discretion [it] deem[s] it advisable for my or [its] protection, sell any or all securities or commodities held in any of my accounts . . ., and [it] may borrow or buy any securities or commodities required to make delivery against any sale effected for me . . . Such sale or purchase may be public or private and may be without . . . notice to me and in such manner as [it] may in [its] discretion determine.

Investors informed First Western of their "tax preference," the amount of tax loss or long-term capital gain they wished to secure. First Western would respond by recommending portfolios of straddles based upon the requested tax-motivated action and the time remaining in the tax year.[3] Because of the high risk involved, the forward contract market in GNMAs and FMACs is dominated by institutional investors. Individual contracts in excess of $1.8 million in size and six months in duration are rare. The portfolios offered by First Western,

[2] Initially, Samuels also formed Samuels & Co. (later Samuels, Kramer & Co.), which served as the "investment advisor" in the First Western program. Because this function was absorbed into First Western at a later date, we omit discussion of Samuels & Co.

[3] The record does not indicate that any investor ever refused to approve First Western's suggested portfolios.

however, had delivery dates ranging from 14 to as many as 30 months; those purchased by the Taxpayers involved over $1.6 billion.

In the typical scenario, investors would provide First Western with a "margin" deposit. Although a margin typically neither limits an investor's potential liability nor is linked to tax considerations, the "margins" paid by First Western's investors were a percentage of their desired tax loss and represented their total liability for trading losses. First Western assessed trading fees against the "margin" until a stated "fee cap" was reached, after which no fees were assessed.

As either buyer or seller, as necessary in *every* transaction with its investors, First Western's unilaterally set all prices. The Tax Court found that the predicates underlying First Western's pricing algorithm ensured that all of its contract prices would move in tandem with the price of the GNMA 9½% coupon and in lockstep with each other.

It is the norm that marketplace investors enter into forward contracts intending to take or make delivery of the underlying security on a specified date. The mere possibility of delivery links the forward market to the cash market in the underlying securities. Delivery never occurred in the First Western program; in fact, First Western's computer program contained no delivery provision.

In lieu of delivery, and as a key element of its program, First Western closed out its investors' positions by cancellation or assignment, methods typically reserved for other kinds of situations.[4] When the loss leg of an investor's straddle achieved the desired tax loss, First Western would cancel the contract to ensure the investor a tax loss for the year.[5] Once the gain leg

[4] Cancellation typically is used to rescind a transaction in the event of error. Assignment typically is used to effect delivery of an underlying security to a third party to whom the purchaser is obligated.

[5] Because cancellation does not involve a sale or exchange, any losses incurred constitute ordinary tax losses.

generated the desired amount of capital gain, First Western would assign the contract to one of three financial entities maintaining an account with it for this specific purpose. First Western closed out the contract with the assignee, credited the assignee's account with one percent of the proceeds, and credited the remaining 99 percent to the investor. No money changed hands.

First Western successfully obtained tax losses for its investors remarkably close to their stated tax preferences.[6] Unfortunately for the Taxpayers, however, the Commissioner marched to a different "tax preference" drummer. The Commissioner determined First Western's program to be a sham and denied the deduction of losses resulting from its transactions. Some 3,000 taxpayers petitioned the Tax Court for a redetermination. The Taxpayers were among ten test cases selected for a consolidated trial, which began in December 1984 before Judge Richard Wilbur. Judge Wilbur fell ill and Chief Justice Sterrett

[6] In those years for which the information is available, the Tax Court found the Taxpayers' desired tax losses and those obtained by First Western to be as follows:

	Requested tax loss		Actual loss
Freytag	$ 70,000	(1979 short term capital loss)	$ 70,539
	100,000	(1979 ordinary loss)	99,403
	100,000	(1980 ordinary loss)	101,794
	130,000	(1981 ordinary loss)	126,188
	140,000	(1982 ordinary loss)	143,001
McCoin	100,000	(1980 ordinary loss)	102,272
Timm	50,000	(1978 ordinary loss)	50,476
	50,000	(1979 short-term capital loss)	58,669
	60,000	(1980 ordinary loss)	62,004
	75,000	(1980 short-term capital loss)	77,611
	85,000	(1981 ordinary loss)	84,523
Womble	280,000	(1980 ordinary loss)	284,744
	131,500	(1981 ordinary loss)	131,682

The margin deposits for the above transactions amounted to $71,500 (Freytag), $10,000 (McCoin), $36,050 (Timm), and $54,000 (Womble).

assigned the cases to a special trial judge for purposes of conducting the trial. Proceedings before the special trial judge were videotaped so Judge Wilbur could review testimony at home.

Judge Wilbur took senior status and the chief judge advised the parties that unless they objected, he intended to assign their cases to the special trial judge for preparation of a report in accordance with 26 U.S.C. § 7443A. One corporate petitioner objected and its trial was severed. Those remaining agreed to the reassignment with the understanding that Judge Wilbur or the chief judge would issue the opinion of the Tax Court, as required by § 7443A(c). The special trial judge filed a proposed opinion finding First Western's transactions to be a sham or, alternatively, that its investors' losses were not deductible because they had not entered into the transactions primarily for profit. The special trial judge also recommended the levying of negligence assessments against the Taxpayers. The chief judge formally adopted the proposed opinion as the decision of the Tax Court. Following two unsuccessful motions for reconsideration, the Taxpayers appealed.

Analysis

1. Jurisdiction of the special trial judge.

Pursuant to 26 U.S.C. § 7443A the chief judge of the Tax Court may appoint special trial judges to preside over (1) any declaratory judgment proceeding, (2) any proceeding conducted under section 7463, (3) any proceeding where neither the amount of deficiency in dispute nor any claimed overpayment exceeds $10,000, and (4) "any other proceeding" so designated by the chief judge. 26 U.S.C. § 7443A(b)(1)-(4). In the first three categories, the court may authorize the special trial judge to render a decision. 26 U.S.C. § 7443A(c). Special trial judges

may not render the formal decision of the Tax Court in cases assigned under the fourth category.

In the instant case, which fell under the "any other proceedings" category, the special trial judge filed his report on October 21, 1987. The chief judge adopted this report as the Tax Court's opinion and formally filed the decision that same day. The Taxpayers contend that by adopting the proposed opinion on the same day it was filed the chief judge in effect permitted the special trial judge to render the "decision" of the Tax Court contrary to 26 U.S.C. § 7443A(c). Inasmuch as this argument is, in essence, an attack upon the subject matter jurisdiction of the special trial judge,[7] it may be raised for the first time on appeal. *C.F. Dahlberg & C. v. Chevron U.S.A., Inc.*, 836 F.2d 915 (5th Cir. 1988).

Our analysis begins and ends with the simple fact that the opinion in this case was issued by the Tax Court in the name of the chief judge. The chief judge had both the obligation and power to maintain full responsibility for the decision in this case. Tax Ct. R. 183(c).[8] We will assume that the judge did

[7] There is no question that the Taxpayers properly invoked the subject matter jurisdiction of the Tax Court when they elected to seek redetermination of their tax liability rather than paying the tax and seeking a refund in federal district court. 26 U.S.C. §§ 6214, 7442.

[8] Although Tax Court Rule 183(c) indicates that the special trial judge's recommended findings of fact shall be presumed correct, it is the division of the Tax Court to which the case is formally assigned that controls the outcome of the case. That division

> may adopt the Special Trial Judge's report or may modify it or may reject it in whole or in part, or may direct the filing of additional briefs or may receive further evidence or may direct oral argument, or may recommit the report with instructions. . . .

Tax Ct. R. 183(c). *But cf. Stone v. Commissioner*, 865 F.2d 342 (D.C.Cir. 1989) (Tax Court must follow the special trial judge's findings of fact unless clearly erroneous). At the time the case under review in *Stone* was decided in the

so in good faith. The record before us is devoid of any evidence that even remotely suggests otherwise, other than the short time span between the filing of the special tax judge's report and the issuance of the Tax Court's opinion by its chief judge.[9]

2. The Tax Court's determination of sham transactions.

The fundamental premise underlying the Internal Revenue Code is that taxation is based upon a transaction's substance rather than its form. Thus sham transactions are not recognized for tax purposes, and losses allegedly generated by such transactions are not deductible. *See e.g., Gregory v. Helvering*, 293 U.S. 465, 55 S.Ct. 266, 79 L.Ed. 596 (1935); ***Forseth v. Commissioner***, 845 F.2d 746 (7th Cir. 1988); ***Enrici v. Commissioner***, 813 F.2d 293 (9th Cir. 1987); ***Bramblett v. Commissioner***, 810 F.2d 197 (5th Cir. 1987) (unpub. op.); ***Mahoney v. Commissioner***, 808 F.2d 1219 (6th Cir. 1987); ***Wooldridge v. Commissioner***, 800 F.2d 266 (11th Cir. 1986) (unpub. op.). Whether a particular transaction is a sham is a question of fact reviewed under the clearly erroneous standard. *Forseth*, 845 F.2d at 748; *Enrici*, 813 F.2d at 295; *Mahoney*, 808 F.2d at 1220.

Although the Tax Court found that no one "gremlin" mandated the conclusion that First Western's program was designed to create sham transactions, it could not help but reach this conclusion in light of the multitude of "gremlins" with which it was confronted. Although they raise several related claims,[10] the Taxpayers primarily contend that the Tax Court's finding that the First Western program was a sham was clearly erroneous in light of the testimony of their own expert witnesses who, they insist, presented unrebutted proof that First Western's contract prices would be considered reasonable in the open market.

To demonstrate the off-market nature of First Western's pricing methodology, the experts called by the Commissioner compared market prices of forward contracts for immediate settlement with the prices resulting from the application of First Western's formula to the same type of contract. The Taxpayers assert that the court's reliance on these analyses was clearly erroneous because First Western traded only in long-term forward contracts. Although First Western did not trade in immediate forward contracts, it is undisputed that there is no market for the 14-to-30-month contracts utilized in the First Western program. Accordingly the only way to compare First Western's prices with market prices was through an analysis of the kind of instruments which in fact were traded in the market.

Were we to assume, *arguendo*, that First Western's pricing formula produced contract prices sufficiently tracking those in the open commodities market, the fact remains that the Taxpayers surrendered total control to First Western over invest-

Tax Court, litigants were furnished with a copy of the special trial judge's proposed opinion and filed exceptions thereto. According to counsel for the Commissioner, litigants are no longer afforded this opportunity; this change in rules, in our view, confirms that the Tax Court's relationship with its special trial judges cannot be analogized to typical appellate review.

[9] Also for the first time on appeal the Taxpayers challenge the constitutionality of section 7443A under the Appointments Clause of the Constitution. By consenting to the assignment of their case at the time it was made, the Taxpayers waived this objection.

[10] The Taxpayers contend that the Tax Court failed to consider any evidence, particularly that of their expert witnesses, relating to their actual transactions with First Western. This contention is without merit. Although it stated that it declined to "delve into the minutiae of the transactions" at issue, the Tax Court explored in detail the dealings of each of the Taxpayers with First Western. Further, inasmuch as all of the deductions at issue stemmed from a common source, the simultaneous assessment of the general functioning of First Western's program was probative of their validity. *See Sochin v. Commissioner*, 843 F.2d 351 (9th Cir. 1988), *cert. denied*, ___ U.S. ___, 109 S.Ct. 72, 102 L.Ed.2d 49 (1988); *Forseth, supra; Enrici, supra; Mahoney, supra.*

ments that, in the real market, are so risky as to be virtually non-existent. As the Ninth Circuit recognized under similar circumstances in *Sochin v. Commissioner, supra*, "no reasonable investor would surrender total control of his or her ability to profit or lose unless satisfied that the risk of loss had been greatly diminished or eliminated." *Sochin*, 843 F.2d at 356.

First Western's absolute authority over the pricing and timing of the transactions that occurred in the self-contained market of its own making enabled it to achieve the tax losses desired by its investors with uncanny accuracy. The Tax Court's recognition that First Western's program made available to its investors an essentially risk-free opportunity to purchase tax deductions cannot be labeled clearly erroneous. *See United States v. United States Gypsum Co.*, 333 U.S. 364, 395, 68 S.Ct. 525, 542, 92 L.Ed. 746 (1948) (fact findings will remain undisturbed unless a review of the evidence leaves "the definite and firm conviction that a mistake has been committed"). Bathed in the harsh light of economic reality the Taxpayers' other factual arguments amount to nothing more than a valiant effort to substitute the testimony of their expert witnesses for the findings of the Tax Court.

3. Deductibility of losses under § 108.

The deductibility of pre-1982 commodity straddles is governed by section 108(a) of the Tax Reform Act of 1984, Pub.L. No. 98-369, § 108, 98 Stat. 494, 630 (1984), as amended by section 1808(d) of the Tax Reform Act of 1986, Pub.L. No. 99-514, 100 Stat. 2085, 2817 (1986). Section 108(a) permits the deduction of a loss if such loss is incurred in a trade or business, or if such loss is incurred in a transaction entered into for profit though not connected with a trade or business . . .

Applying section 108(a) to the Taxpayers' transactions with First Western, the Tax Court held in the alternative that even if the transactions generated by First Western were not shams, the losses in question were nonetheless not deductible because the Taxpayers had not entered into the transactions with a primary motive of economic profit.

Taking exception to the primary motive test applied by the Tax Court, the Taxpayers contend that section 108(a) requires only that their transactions have had a "reasonable prospect of profit." Although this argument does not affect the Taxpayers' liability in light of our affirmance of the Tax Court's sham determination, we conclude that we ought to address it briefly, for purposes of comprehensiveness, even if only to reject it. This circuit, along with every other circuit plumbing congressional intent underlying section 108(a), has held losses to be deductible under that provision only if the taxpayer entered into the transaction primarily for profit. *See Killingsworth v. Commissioner*, 864 F.2d 1214 (5th Cir. 1989); *Dewees v. Commissioner*, 870 F.2d 21 (1st Cir. 1989); *Friedman v. Commissioner*, 869 F.2d 785 (4th Cir. 1989); *Kirchman v. Commissioner*, 862 F.2d 1486 (11th Cir. 1989); *Landreth v. Commissioner*, 859 F.2d 643 (9th Cir. 1988); *Miller v. Commissioner*, 836 F.2d 1274 (10th Cir. 1988).[11]

4. Additions to tax for negligence under section 6653(a).

Finally, the Taxpayers attack the Tax Court's determination that they were liable for negligence penalties pursuant to 26

[11] Again, the Taxpayers contend that the Tax Court reached this conclusion without consideration of the specific transactions in which they engaged. Again, this contention is without merit. The Tax Court's assessment of their primary motivation was made against a backdrop of extensive findings regarding the Taxpayers' dealings with First Western. In light of all the evidence, the Tax Court was fully justified in its conclusion that "it is simply ludicrous to suggest that these petitioners had anything but a most fleeting interest in a potential economic gain."

U.S.C. § 6653(a). Once the Commissioner has determined that a negligence penalty is appropriate, the taxpayer bears the burden of establishing the absence of negligence. *Marcello v. Commissioner*, 380 F.2d 499 (5th Cir. 1967), *cert. denied*, 389 U.S. 1044, 88 S.Ct. 787, 19 L.Ed.2d 835 (1968). The Tax Court found that the Taxpayers had failed to discharge this burden. We agree.

All of the Taxpayers were professionals with investment experience that should have alerted them to the questionable financial validity of the First Western program. As the Tax Court found, however, this was not the case. Womble and Timm, who demonstrated no understanding of the way in which straddles and forward contracts function, failed to take even the most rudimentary steps to investigate the bona fides of the financial aspects of the First Western program — despite the fact that, under the literal terms of the forward contracts they purchased, they could have been required to take or make delivery of millions of dollars' worth of GNMAs or FMACs. Instead, they relied upon the advice of their "finders," who apparently had no expertise whatsoever in the financial aspects of the portfolios involved. We cannot conclude that the court's assessment of the negligence penalty against Womble and Timm was clearly erroneous.

As "finders themselves, Freytag and McCoin had even more reason to question the validity of the First Western program. Despite claims that they engaged in extensive investigation before investing in First Western, neither disputes the Tax Court's finding that they both were aware that the so-called margin deposit was a charade and that First Western's program was "controlled to the point that any meaningful risk was virtually nonexistent." We affirm as well, therefore, the Tax

Court's assessment of negligence penalties against Freytag and McCoin.[12]

The decision of the Tax Court is in all respects AFFIRMED.

[12] The Taxpayers also contest on due process grounds the retroactive application of the interest penalty for tax-motivated transactions under 26 U.S.C. § 6621(c). Inasmuch as they raised this motion for the first time in the Tax Court by way of a second motion for reconsideration, the court did not abuse its discretion in refusing to address the issue. Nor will we.

APPENDIX B.

United States Tax Court.

THOMAS L. FREYTAG AND SHARON N. FREYTAG, ET AL., PETITIONERS V. COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket Nos. 4934-82, 9307-82, 27146-82, Filed October 21, 1987.
29012-82, 1240-83, 3250-83,
8616-83, 33016-83, 204-84,
3749-84, 7658-84, 11821-84.

OPINION

STERRETT, *Chief Judge*: This case was assigned to Special Trial Judge Carleton D. Powell pursuant to the provisions of section 7456(d) (redesignated as section 7443A(b) by the Tax Reform Act of 1986, Pub. L. 99-514, section 1556, 100 Stat. 2755) and Rule 180 et seq.[1] The Court agrees with and adopts the opinion of the Special Trial Judge that is set forth below.

OPINION OF THE SPECIAL TRIAL JUDGE

POWELL, *Special Trial Judge*.: There are currently more than 3,000 cases in this Court that involve the issues presented in these cases. The common denominator of all the cases is that each petitioner entered into alleged financial transactions involving forward contracts for Government mortgage-backed securities with First Western Government Securities (First

[1] All statutory references (except as to sec. 108 of the Tax Reform Act of 1984) are to the Internal Revenue Code of 1954 as amended, and as in effect during the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure, except as otherwise provided.

Western). These cases were selected as so-called test cases.[2] As we view the cases, the primary issues for decision are: (1) Whether these transactions should be recognized for Federal income tax purposes, (2) if so, whether they were entered into for profit under the standard set forth in section 108 of the Tax Reform Act of 1984, as amended, and (3) whether certain petitioners are liable for additions to tax for negligence.

FINDINGS OF FACT

A. *First Western, the Supporting Characters, and the Program*

First Western is an Illinois corporation with offices in New York, New York, and San Francisco, California. Its president and sole shareholder, Sidney Samuels. Mr. Samuels holds a law degree. He was a revenue agent of the Internal Revenue Service and subsequently was in private practice in California until 1977. In 1977, he became a general partner in Price & Co.,[3] a dealer in stock options. In 1978, he formed Samuels & Co. (later Samuels, Kramer & Co.) and First Western. Samuels & Co. was an investment advisory company specializing in the futures markets. First Western is described by Mr. Samuels as a dealer in Government securities. From 1978 to mid-1980, Samuels & Co. advised customers with respect to transactions with First Western by recommending "portfolio selections" of forward contracts based on the customer's interest rate forecast. After that time, First Western took over the functions of Samuels & Co.

[2] The years and deficiencies involved, residences of petitioners at the time the petitions were filed, and respondent's adjustments are set forth in the Appendix.

[3] See *Price v. Commissioner*, 88 T.C. 860 (1987).

In 1978, First Western began marketing portfolios of "forward contracts" for securities of the Government National Mortgage Association (GNMAs) and the Federal Home Loan Mortgage Corporation (FMACs).

GNMA Securities, also commonly referred to as "Ginnie Mae's," are registered certificates which represent undivided interests in a specified pool of mortgages guaranteed by GNMA, the Veteran's Administration, the Federal Housing Administration, or the Farmers Home Administration. These pools contain approximately $1 million of mortgages. GNMA security holders are protected by the full faith and credit of the United States Government. The stated maturity of a GNMA pool depends on the mortgages that underlie it. During the period with which we are concerned, the coupon or interest rate of the pools in existence varied between 6.5 and 16.5 percent. Most single-family, residential mortgages carry a stated maturity of 30 years.

Although Ginne Mae's are not callable, the underlying mortgages may be prepaid at any time. Due to the prepayment of principal on single family home pools, the average maturity of a pool is considerably less than 30 years. High coupons would pay down faster than low coupons, particularly when interest rates fall. The market practice is to quote Ginnie Mae yields on a pool of such mortgages to a 12-year half-life (i.e., the point in time when the principal amount of the pool is expected to be repaid). FMAC securities or "Freddie Macs" are participation certificates representing an undivided interest in a pool of conventional (non-VA and non-FHA) mortgages, the principal and interest are guaranteed by the Federal Home Loan Mortgage Corporation, a corporation owned by the Federal Government. They also are subject to prepayments. While there are differences in these securities, for our purpose, those differences are not relevant.

The Portfolios

A forward contract is a transaction in which two parties agree to the purchase and sale at a future time, known as the settlement date, of a commodity, financial instrument, or security under the terms negotiated by the parties. Forward contracts are similar in concept to futures contracts; the latter, however, are for short periods of time, contain standardized terms, and are traded on a regulated board of exchange. GNMA and FMAC forward contracts are exempt from registration under the Securities Act of 1933. Forward contracts in these securities were developed because, while the mortgagee was committed to loan the funds, the actual mortgage would not come into existence for 60 or 90 days. During this time, the mortgagee was at risk. Thus the concept originated as a device to "hedge" that risk. There is an active market for forward contracts; however, that market was not designed for individual investors.[4] In the market, forward contracts for 5 or 6 months or longer are rare because of the extreme financial risks involved.

A forward contract to purchase a security, or a "long position," represents an obligation to accept delivery of the underlying security on a specified day. A forward contract to sell a security, or a "short position," represents an obligation to make delivery of the underlying contract on a specified day. An outright or "naked" long or short position involves great risk. The risk in an outright position is that the price of the underlying security will rise or fall.

The simultaneous holding of a long position for one settlement date and a short position for another settlement date constitutes a "straddle." The long and short positions are commonly referred to as the "legs of the straddle." A straddle theoretically enables an investor to close out the loss leg and

[4] An individual trading even a $1.8-million contract is very unusual.

offset the loss recognized against ordinary income or capital gain from another source, while holding the gain leg open until a later year with an offsetting position to protect the unrealized gain. This technique theoretically results in both tax deferral and conversion of ordinary income into long-term capital gain. In a straddle position, the risk is that the spread or the difference between the prices of the two legs will widen or narrow. With respect to the petitioners, First Western dealt only in complete portfolios of straddles in GNMA and FMAC forward contracts.

First Western structured the portfolios such that the short and long legs of the straddle consisted of forward contracts calling for the delivery of underlying securities with different interest rate coupons and different settlement dates. The settlement dates of these contracts were often 18 months and longer. These strategies are called "coupon spreading" and "time spreading," respectively, and they implement several market assumptions. First, the price of fixed income securities is inversely related to the market interest rate. Second, the price of a higher coupon security changes more, for a given change in interest rate, than that of a lower coupon security. This assumption is critical to the First Western theory of coupon spreading. Third, the longer the maturity of a fixed income security, the greater will be its change for a given change in interest rate. Fourth, the larger the portfolio, the larger will be its dollar change in value for any change in the interest rate. These assumptions require that all other market variables remain constant.

Prices

The prices for the GNMA forward contracts in issue were not quoted on an exchange. Rather than consult the primary

dealers for a market price,[5] First Western used computerized pricing algorithms to set prices for the forward contracts involved here. First Western did not quote its prices to market dealers.

Prior to January 14, 1980, First Western used the Telerate[6] quote for the cash price of a GNMA 9.5 coupon to generate cash prices for other GNMA and FMAC coupons. From the Telerate composite quote for the cash price of the GNMA 9.5, First Western calculated the GNMA yield for this security. This step is called a price-to-yield conversion. First Western then calculated various coupon yields by assuming a constant yield spread between any two GNMA or FMAC coupons — always equal to 20 percent of the difference between two GNMA's or two FMAC's and always equal to 0.03 percent as between a FMAC and a GNMA with the same coupon rate.[7] This step is called a yield-to-price conversion.

From these assumed GNMA and FMAC yield numbers, First Western calculated cash prices on which it traded forward contracts. Specifically, First Western calculated the cash price for each GNMA and FMAC coupon that would result in a GNMA yield or FMAC yield already calculated for that coupon.

[5] Dealers determine the market price for forward contracts in Government mortgage-backed securities by calling a number of other deals and asking each to quote a price. Dealers, however, did not make markets in the long-term contracts that First Western wrote.

[6] Telerate, Inc., provides composite quotations of bid and ask prices for GNMA's available for immediate and for delayed delivery. During the years 1978 through 1982, Telerate never quoted prices for GNMA forward contracts with settlement dates more than 6 months in the future. First Western, however, wrote forward contracts with average delivery dates of 14 to 22 months in the future, and it wrote some contracts with delivery dates as far out as 30 months.

[7] Robert Shiffer, one of respondent's experts, testified that only once in 16 years had he observed a 3-day constant yield spread between securities. That case involved a dishonest employee who deliberately programmed the computer to show a constant yield spread between the two securities, and it cost his firm $1.2 million.

First Western used these assumed cash prices as a starting point from which to calculate forward prices. In so doing, First Western assumed a linear relationship between the forward price for each maturity and the cash price. In other words, forward prices for all coupons and maturities precisely tracked the movement in the cash price, which itself depended on the price of the GNMA 9.5.

First Western produced this linear relationship between cash prices and forward prices by using its own cost of carry model which entailed a number of implicit and explicit assumptions. First Western assumed a constant 10.65-percent cost of carry on forward contracts with maturity dates of up to 2 years in the future.[8] Also, First Western implicitly assumed there would be no prepayments in any mortgage pools before the maturity of the forward contract. Since a forward contract specifies delivery of an agreed face amount of a particular GNMA or FMAC coupon, holders of long positions in forward contracts, unlike holders of GNMA or FMAC securities, enjoy protection against prepayment during the life of the forward contract. Thus, forward contracts would be theoretically more valuable than a cost-of-carry calculation assuming no prepayments would predict. This would be especially true for seasoned high-coupon GNMA's or FMAC's and would become increasingly important as interest rates fall.

In sum, prior to January 14, 1980, First Western's pricing formula made several assumptions which reduced the risk that prices of different contracts would move independently. For example, the assumption of a constant yield spread among all coupons eliminated the risk that cash prices for these coupons

[8] In a period of high interest rate volatility, the assumption of a 2-year constant carry rate is arbitrary and simply untenable. During the period in issue the interest rates on 2-year Treasury notes, a comparable default-riskless security ranged from 7.57 percent to 16.48 percent. Similarly, interest rates on 3-month Treasury bills ranged from 6.29 percent to 16.30 percent.

would move independently. Similarly, the assumption of a constant carry rate eliminated the risk that longer maturity forward prices would move independently of shorter maturity contracts due to changes in the prevailing market interest rate. By making these assumptions and by limiting the market data input to the cash price of the GNMA 9.5, First Western insured that its forward contract prices moved in lockstep with the price of the GNMA 9.5, and with each other. As a result First Western's pricing algorithm guaranteed that the two legs of any straddle moved in tandem. Essentially, First Western assumed away all market risk other than movement in the price of the GNMA 9.5

Effective January 14, 1980, First Western unilaterally altered its pricing calculations for purported reasons of "empirical" risk control. The changes implemented were twofold. First, First Western calculated cash prices differently for all coupons, including the GNMA 9.5 benchmark, by adding an "adjustment factor." In other words, First Western took the GNMA 9.5 cash quote from Telerate and added to it an adjustment factor to obtain its own GNMA 9.5 cash price. By adding the adjustment factor, First Western reduced the volatility of its own cash price for the GNMA 9.5 relative to that of the market price for the same security.

Second, First Western changed its cost-of-carry calculation for forward contracts. Previously, First Western calculated the cost of carry using the standard time frame between the current date and the maturity date of the forward contract. After January 14, 1980, however, First Western calculated the cost of carry for the time period between January 14, 1980, and the maturity date.[9] This cost-of-carry calculation is completely

[9] The following example serves to illustrate the impact of this change on First Western prices. Under the original formula, if First Western priced a contract on Jan. 1, 1983, for delivery on Mar. 1, 1983, it would add 2 months' cost of carry to the calculated cash price of the underlying coupon. Under the

arbitrary and is unrelated to any standard financial calculations or analysis.

First Western implemented these pricing modifications after a dramatic increase in the level and volatility of both mortgage interest rates and Treasury bill and note rates. As a practical matter, "empirical risk control" was simply a means by which First Western achieved an even greater degree of control over the pricing of its contracts; first, by substituting a constant for a variable time in the calculation of forward prices from spot prices and, second, by systematically attenuating the effects of market influences on the price of the GNMA 9.5 — the only point of contact between First Western's contracts and the actual market.

The market risks of increased price volatility, increased carry rates, and independent price movement cause true issuers of forward contracts in fixed income securities to limit the size of the positions they allow their customers to take. Avoiding market prices and their inherent risk enabled First Western to structure straddle portfolios with uncommonly large positions. As a result, First Western offered its clients enormous tax benefits compared to their "margin" deposits and without increasing its own risk of loss.

Settlements

Settlement of forward contracts is predicated on the assumption that delivery of the underlying security will be made.[10]

Whether or not actual delivery takes place, the effective possibility of actual delivery, combined with the possibility of entering into individual contracts, gives economic reality to forward and futures markets for financial instruments. The

new formula, using the same example, First Western would add over 3 years' cost of carry to the adjusted cash price.

[10] Dealers customarily execute every trade with the intent to deliver.

effective possibility of delivery links the forward or futures market to the underlying cash market because the forward or futures price must nearly converge with the cash price of the underlying financial instrument as the maturity of the forward or futures contract approaches. Otherwise, arbitragers could make riskless profits by taking opposite positions in the forward market and the cash market and closing out the position by going to actual delivery.[11]

The other general method of settlement of a futures contract is "setoff." This occurs when the parties enter into an opposite contract for the same security and agree to offset or pair off the liabilities of both contracts. On settlement, the difference in the prices of the two contracts is paid in cash.

In First Western's program, physical delivery, the actual transfer of the underlying instrument, did not occur.[12] Indeed, First Western's computer program contained no provision for delivery.

First Western used two additional methods of settling contracts that, while having their genesis in the jargon of financial transactions, were used in a fashion far different from that generally contemplated. Generally, cancellation is used, as its name suggests, to rescind or cancel a transaction in case of an error or where there is a substitution of contracts. First Western and its customers, however, used cancellation in situ-

[11] For example, if the forward price exceeds the cash price at the maturity of a forward contract, arbitragers will buy the instrument in the cash market at the lower price and sell it in the forward market at the higher price, thus making a riskless profit.

[12] There are several reasons why First Western clients avoided delivery. One explanation is that the clients would have been financially incapable of making or taking delivery (due to the size of the positions in their portfolios). Also, clients always held entire portfolios rather than individual contracts. Since the two sides of the portfolio were similar in size, if a client went to delivery on contracts on one side of the portfolio, First Western might go to delivery on contracts on the other side of the portfolio and thereby decrease the client's net gain.

ations where there were no errors or substitutions. Rather, "cancellation" was used because theoretically it resulted in ordinary gain or loss for want of a sale or exchange.

The second unorthodox method of closing transactions was by assignment. Again, an assignment of a contact has a place in the financial markets. It is used to effect delivery of a security to a third party to whom the purchaser is obligated. First Western, however, used assignments as a substitute for sales necessary to achieve a capital gain or loss. First Western controlled whether a client could assign or cancel a contract. First Western charged fees for cancellations and assignments.

First Western's use of these latter methods of settlement was solely for tax purposes. Legs of straddles with losses generally would be canceled. The gain legs generally would be assigned. In these cases, the assignors' (petitioners') accounts with First Western were credited with approximately 99 percent of the net "value" of the contract. The assignments in these cases were to Benson Financial (Benson), Ionian Financial Ltd. (Ionian), or National Mortgage Corp. of America (National Mortgage).

The settlement by First Western of the contracts "assigned" to Benson, Ionian, and National Mortgage was peculiar. The contracts provided that "The coupon rate specified above is the only coupon that may be delivered." It does not appear, however, that any of the assignees ever demanded delivery. Rather, the accounts were apparently settled for cash, whereby the assignees received approximately 1 percent of the value of the contract at the time the contracts were assigned. That value was determined by First Western's pricing. In the case of petitioner Harby, for example, First Western's records showed that he assigned contracts to National Mortgage having a net value of $143,523 on March 3, 1982. The assignment, however, was dated March 23, 1982, and bears a "received" stamp of May 19, 1982. The contracts that were assigned had

expiration dates of March 7, 1982, and May 19, 1982. First Western's "Schedule of Assignment Fees" lists $1,450 as the amount "due" National Mortgage from the assignment. National Mortgage's account with First Western shows that the assigned contracts were put into National Mortgage's account with First Western where they immediately were "canceled" or "set off" with debits to its margin account and credits to the assignors' accounts. Thus, there was absolutely no risk to the assignee, the assignor, or First Western.

The assignments to Benson and Ionian were similar. In total, by May 31, 1983, Benson received assignments having a value of $22.8 million, Ionian $298.3 million, and National Mortgage $117.8 million. While the exact amount that National Mortgage received is unclear, Benson received $228,019 and Ionian $1.3 million from First Western.

Margins and Fees

A margin is a good-faith deposit made by a trader with a dealer and is not a downpayment on the security. In the marketplace, the customer's margin neither limits his potential liability nor bears any relationship to tax considerations. The First Western program, however, based margin requirements on the client's "tax preference" (viz., the requested amount of tax loss to be realized in a given year). Furthermore, First Western limited its customers' potential monetary loss to their initial margin.

For an over-the-counter market maker, fees are generally a function of price. A dealer, for example, will "mark up" the price of the security in its "ask" price. First Western's fees, in contrast, were merely a function of the customers' "tax preference." On First Western's books, the fees were immediately "budgeted" out of the "margin," and a fee cap was established. The budgeted fees were ranged between 40 to 70 percent

of the margin,[13] or 7 to 8 percent of the tax preference. Thereafter, fees were charged against the account on the various transactions until the budgeted fees were satisfied.

Hedging

Actual dealers in securities of this nature use hedging to limit their risks. A perfectly hedged dealer would be in balance — i.e., it would be short the same amount of contracts as it would be long. This would be desirable in times of market volatility. First Western maintained an account with Conti Commodity (Conti) that it claimed was a hedging account for purchasing futures of GNMA's. While First Western may have maintained an account with Conti, its daily hedging reports show extremely large exposures, particularly in view of the prevailing interest rate volatility and First Western's limited capital. These reports reveal that First Western was routinely exposed to the extent of many times its net worth. First Western's balance sheets that are in the record showed the following equity:

Date	*Amount*
Dec. 31, 1979	$3,413,000
Mar. 31, 1980	2,615,000
Mar. 31, 1981	17,937,000
Mar. 31, 1982	[14]6,339,000

The following is a limited list of First Western's exposure on certain dates:

[13] In other words, because First Western took approximately 50 percent of the margin deposit as its fee, the client had to double his investment before he could make a profit.

[14] At some time between Jan. 1 and Mar. 31, 1982, all the outstanding stock of First Western was transferred from Sidney Samuels to First Western Investments, Inc., and a $20 million dividend was paid.

Date	*Amount*
Nov. 11, 1980	$30,4 million
Jan. 23, 1981	53.2 million
Mar. 24, 1981	48.9 million
Apr. 14, 1981	[15]1.1 billion
June 25, 1981	26.0 million

For substantial periods of time, the number of futures contracts that were the predicate for the hedging program remained constant. Furthermore, at least on one occasion First Western was hedged the wrong way — its risk was on the short side and its "hedging" account was also short.

First Western, however, had other methods of controlling risk. When a leg was "canceled" another leg with contracts of similar coupons and time lengths to those in the open leg would be purchased or sold short. Since the pricing algorithms essentially guaranteed that the values of the contracts would move in lockstep, the account was, in First Western's terminology, "neutralized."

B. *Finders and Customers*

While there were nine test-case petitioners,[16] we find it unnecessary to delve into the minutiae of the transactions between each petitioner and First Western. Rather, it seems to us more relevant to highlight the relationship as reflected by the general business dealings between First Western and its customers. In

[15] This was claimed to be a statistical "glitch." But if, as Mr. Samuels and Mr. Bender testified, these reports were reviewed daily, it is difficult to see how such a glitch would not have been spotted immediately and corrected. If it were a glitch, that omission from that data would not alter our overall view on the propriety of the hedging program.

[16] Originally there were 10 test cases. Wilhide, however, was severed. The remaining petitioners have agreed to be bound by the record containing facts relevant to Wilhide as they relate to First Western's program.

this regard, we note that, while the transactions of the test case petitioners with First Western may be typical, the individual petitioners are not typical because of the non-random selection process of the test cases. Petitioners chose five cases, and respondent chose five cases. Understandably, both sides chose cases that were more favorable to their respective views of the First Western transactions. For example, four of the nine test-case petitioners had profits; in First Western's program, however, approximately 3 percent of its customers had profits from trading its forward contracts, and of this latter number, First Western employees showed substantial profits, with Mr. Samuels leading the pack. Nevertheless, somewhat of a pattern does emerge from the test cases.

First Western did not advertise. Rather, its program was spread by word of mouth among accountants, lawyers, and financial consultants — the "finders."[17] Finders were paid by First Western — the remuneration was based upon a percentage of the margin and tax preference. In some cases, the finders also charged their clients. Typically, a finder or customer would obtain a package from First Western. In cases where "finders" were involved, at least as far as the test cases reveal, the customer had little or no understanding of the program.

Womble

Petitioner Womble is a physician.[18] During the last quarter of 1980, he contacted Robert Taylor, an attorney in Dallas,

[17] As noted before, originally Samuels & Co. (later Samuels, Kramer & Co.) and First Western had different functions. Samuels & Co. designed the portfolio and First Western executed the "trades." Later the former function was absorbed into First Western; there is not, however, any substantive difference in the two methods of operations. Accordingly, for simplicity we omit the role played by Samuels & Co. from our discussion.

[18] Dr. Womble's transactions with First Western were conducted through a partnership (Investadox) of which he was the administrative partner. During

Texas. Taylor had written a "Confidential Memorandum to Interested Clients" in which he outlined "the best potential tax shelter investment I have reviewed in the last ten years." The memorandum noted "an investor would show a tax loss of eight to one [and], [i]f the investment is successful the investor may receive a cash profit along with a tax loss — an infinite ratio,"[19] Robert Taylor subsequently wrote to Dr. Womble:

> Shortly before the money went in for this partnership investment, First Western Securities decided to allocate a slightly higher amount of the investment to the margin account itself. The reason for this is to give flexibility for additional trades to generate gains and protect the investment from attack by the Revenue Service on the ground that there is no profit motive.
>
> The net result will be that the total amount of losses generated for 1980 will be slightly less than the $300,000 contemplated, but not enough to make very much difference. By the time the trading is completed for this year, my guess is the total loss available will be in the $280,000 to $290,000 range. Every $7,000 invested should still receive losses in the neighborhood of $46,000 to $49,000 for the year, depending upon the results of the trading.

Dr. Womble executed the standard First Western documents — an interest rate forecast, a standard customer's agreement, and a new account application. The customer's agreement pro-

the trial, the parties have essentially ignored the partnership entity and, for the purposes of this discussion, we do the same.

[19] Petitioners assert that respondent cannot attribute this statement to First Western. Perhaps not, but the statement is clearly indicative of the perception of the program that many participants shared.

vided, inter alia, that First Western "may without demand for margin, whenever in [its] discretion [it] deem[s] advisable for my or [its] protection, sell any or all securities held in any of my accounts * * *, and [it] may borrow or buy in any securities required to make delivery against any sale effected for me * * *. Such sale or purchase may be public or private and may be without * * * notice to me and in such manner as * * * [it] in * * * [its] discretion may determine." These documents were forwarded to A. F. Campbell & Co. (a finder) with checks totaling $42,000. Campbell then sent the package including a "tax data" statement to First Western's office in San Francisco. The "tax data" statement requested an ordinary loss for 1980 in the amount of $280,000 and a long-term capital gain for the year 1982 in the amount of $280,000. The San Francisco office generally put this information in its computer, aggregated all requests received that day, and sent them by a "night letter"[20] to the New York office. Portfolios of straddle positions were then constructed by a computer, the prices set by the algorithm discussed above. On November 26, 1980, First Western transmitted the proposed portfolio to Dr. Womble. This communication provided that "[u]nless you advihe [*sic*] us otherwise by 1:00 PM EST on November 28, 1980, we will execute the required trades at the prices current on that date."[21] The portfolio provided:

Action	*Issue*	*Settlement date*	*Face value*
Sell short	GNMA 9.00%	3/17/82	$8,500,000
Sell short	GNMA 11.00	3/17/82	7,500,000
Buy	GNMA 10.00	6/16/82	8,500,000
Buy	GNMA 8.00	6/16/82	7,600,000

Dr. Womble received confirmations dated November 28, 1980, showing the price of each coupon. On December 9, 1980, Dr. Womble received the following confirmations:

Sell short	GNMA 11.00%	3/17/82	$600,000
Buy	GNMA 8.00	6/16/82	9,900,000

On December 11, 1980, the following transactions were confirmed:

Short sale	GNMA 11.00%	3/17/82	$800,000
Buy	GNMA 8.00	6/16/82	900,000

On December 15, 1980, the following transactions were confirmed:

Buy	GNMA 9.50%	10/20/82	$3,800,000
Buy	GNMA 8.50	10/20/82	3,300,000
Buy	GNMA 9.50	9/15/82	3,200,000
Short sale	GNMA 9.00	3/17/82	1,200,000
Canceled	GNMA 8.00%	6/16/82	9,900,000

On January 22, 1981, the following transactions were confirmed:

Buy	GNMA 10.00%	10/20/82	$4,600,000
Sell short	GNMA 11.50	5/19/82	1,200,000
Buy	GNMA 8.50	10/20/82	1,000,000
Canceled	GNMA 8.00	6/16/82	7,600,000
Canceled	GNMA 11.00	3/17/82	600,000
Canceled	GNMA 11.00	3/17/82	800,000
Canceled	GNMA 9.00	3/17/82	1,200,000

On February 2, 1981, Campbell sent to First Western another tax data sheet requesting an ordinary loss of $131,000 for 1981 and a capital gain of $131,500 for 1983. Three days later, First Western sent a letter to Dr. Womble requesting an additional "margin" of $16,900 within 5 days. This letter was rescinded on February 18, 1981.

The trading process repeated itself with various purchases, short sales, and cancellations. On December 7, 1981, First Western wrote a letter requesting an additional $12,000 margin

by December 17, 1981. For 1980 and 1981, First Western's transactions resulted in losses in the amounts of $284,744 and $131,682, respectively. On February 2, 1982, First Western wrote to Dr. Womble informing him that he had forward contracts coming due during that year. First Western records show that the contracts were assigned to National Mortgage on February 26, 1982. Dr. Womble assigned those contracts to National Mortgage for approximately 99 percent of their net value. Some of the contracts assigned had settlement dates expiring over a year later. On April 6, 1982, Dr. Womble received a check in the amount of $6,117 from First Western closing out the account. Dr. Womble's out-of-pocket loss was approximately $48,000, not considering the purported tax benefits he received.

While Dr. Womble had some financial experience, it is obvious that he had very little understanding of First Western's program. He did not know that First Western made the market in these securities. He believed he could check First Western's prices by looking in the Wall Street Journal, but he never did. He had no knowledge of First Western's fee structure. He never attempted to verify whether his interest rate forecast was, in fact, correct. He had predicted that interest rates would go up and never changed that forecast. In May 1981, however, First Western changed his forecast, and Dr. Womble was not aware of the change. We find this somewhat bemusing because, while there were peaks and valleys, interest rates generally did increase during this period. When questioned about the initial proposed portfolio, he responded: "I bought Ginnie Maes at 10 and at 8 * * * [a]nd I sold at 9 and 11." This apparently refers to the coupon of the contract, and clearly indicates that he had no understanding of that portfolio.

Lewis

Petitioner Lewis is an engineer. He was introduced to First Western by Marvin Neese whom he had known for only 3 or 4 months. Mr. Lewis had no knowledge of Mr. Neese's financial expertise except that he managed other First Western accounts. Nonetheless, he simply turned the account over to Mr. Neese. Mr. Lewis never understood the portfolio selection, never checked prices, did not know what a mortgage-backed security was, did not know that there was no market for mortgage-backed forward contracts for delivery in 14 to 22 months, and did not know the difference between a future and a forward contract. Mr. Lewis invested $5,000 in First Western's program. First Western first informed Mr. Lewis of the trades it had devised to implement his interest rate forecast by letter dated August 29, 1979, even though it executed trades for him on August 6, 1979. The account records show that he (or Mr. Neese) requested a $50,000 loss for 1979 and a $35,000 loss for 1980. Among other deductions and losses related to First Western, he claimed ordinary losses of $49,305 for 1979, and $37,768 for 1980. On April 28, 1982, First Western credited Mr. Lewis's account with $9,463 from National Mortgage, for contracts that had been "assigned," even though Mr. Lewis did not assign the contracts until June 4, 1982. Mr. Lewis's situation is exceptional in that he took out more money than he put in.

Harby

Another successful player in the First Western program was petitioner Harby, a retired Army officer who also relied on Mr. Neese. Col. Harby had no knowledge of the fee structure, he was "embarrassingly naive about this program," he had little knowledge of mortgage-backed securities, did not know

that there was no market for 14- to 22-month forward contracts, did not understand the difference between offset and cancellation, and did not know the difference between future and forward contracts.

For 1979, First Western was requested to produce a $50,000 loss, and Col. Harby claimed a deduction in the amount of $54,777. For 1980, a total loss of $68,500 was requested, and a $76,624 loss was claimed. For 1981, a $50,000 loss was requested and a $33,798 loss was claimed. There is, however, one aspect of Col. Harby's account that is noteworthy. On November 19, 1980, First Western canceled a contract in which Col. Harby had a $30,450 profit. Col. Harby wrote to First Western on January 16, 1981, eight weeks later, and in the subsequent tax year, and requested that the contract be "reinstated" because the cancellation had not been "authorized" by him. We find it peculiar that an investor, allegedly seeking a profit, would seek to eradicate a $30,000 profit. Nonetheless, and notwithstanding the provisions of the agreement with First Western giving First Western the authority to trade, First Western reinstated the contract. The contracts in Col. Harby's account were assigned to National Mortgage on March 3 and May 7, 1982, and credits were made to his account. Col. Harby did not execute the assignment forms, however, until March 23 and July 6, 1982.

Poulos

Dr. Poulos is a surgeon who was introduced to First Western by Robert Schmidt. Mr. Schmidt is an "estate planner" operating through "Interplan, Inc." Dr. Poulos "really didn't understand" First Western's program and relied on Mr. Schmidt. Mr. Schmidt received payments from both First Western and Dr. Poulos for his services. In 1978, Dr. Poulos paid $15,000 to First Western and requested a $150,000 ordinary loss. He claimed a loss of $152,359 on his 1978 tax return. Dr. Poulos did not receive confirmations for the 1978 trades made in November and December until April 13, 1979. For 1979, Dr. Poulos paid to First Western $27,500[22] and on September 26, 1979, requested an ordinary loss of $175,000 and a short-term capital loss of $100,000.[23] On his return for that year, he deducted a $183,416 ordinary loss and reported $39,671 as a net short-term capital gain. For 1980, Dr. Poulos paid to First Western $19,500, and requested a $150,000 ordinary loss. Dr. Poulos reported on his 1980 return a short-term capital gain of $241,380, a short-term loss of $209,720, and an ordinary loss of $167,244. By an assignment dated March 1, 1982, Dr. Poulos assigned the contracts in his account to Ionian, and his account was credited with $413,586. Dr. Poulos lost money if no consideration is given to the tax deductions. In addition, Dr. Poulos paid Mr. Schmidt (through Interplan, Inc.) $7,500 in both 1978 and 1980 and deducted these amounts on his tax return. He paid Mr. Schmidt (again through Interplan) $10,750 in 1979 and claimed a deduction in the amount of $12,500. There is no basis in this record for determining what portions of these fees were for services other than those connected with First Western's program.

Timm

Mr. Timm is a geologist and was also introduced to First Western by Mr. Schmidt. Like Dr. Poulos, Mr. Timm did not understand the First Western program and relied on Mr. Schmidt. For 1978, Mr. Timm paid $5,000 to First Western,

[22] An additional $2,250 was transferred to First Western from Dr. Poulos' account with Conti.

[23] Dr. Poulos realized a $144,858 gain on Mar. 26, 1979, and reported that gain on his return. His transactions with First Western after Sept. 26, 1979, resulted in a short-term capital loss of $105,188.

and Mr. Schmidt requested a $50,000 ordinary loss. On his 1978 return, Mr. Timm claimed an ordinary loss in the amount of $50,476. He also deducted $2,500 as "investment counsel fees," apparently for services rendered by Schmidt. As with Dr. Poulos, Mr. Timm did not receive confirmations for 1978 First Western transactions until April 13, 1979. After the 1978 year, Mr. Schmidt wrote to Mr. Timm:

> We reduced the risk of trading government securities by entering into a spread technique with those instruments used in the forward (over-the-counter) market. We leveraged (traded large purchases on a small margin) your investment to purchase instruments with a total face value of $4 million. By canceling one-half of the forward contracts on December 28th, you sustained a $50,476 ordinary loss. To complete the hedging technique, the remaining forward contracts sold in 1979 have resulted in a short term capital gain of $49,536. This loss reduced your 1978 income taxes by (an estimated) $17,600. When deducting the cost of your investment of $4,440 from your tax savings, your estate has increased by approximately $13,225. This equates out to a 298% net capital return in six months. The interest return, when properly reported on an annual basis, would be 595%.

In July 1979, Mr. Timm sent First Western another $5,000. Mr. Schmidt wrote to Mr. Timm, on July 23, 1979, that he "cannot complete your tax shelter until all fees are paid." The letter concluded "my limited time can only be spent with clients who are willing to pay for services rendered." Mr. Timm sent Schmidt a check of $1,000 and Schmidt submitted a tax data sheet on September 24, 1979, requesting a $50,000 short-term

capital loss (to offset the 1979 gain from the 1978 program) to be rolled into a long-term gain in 1981. For transactions with First Western, Timm deducted a short-term capital loss in the amount of $58,669.[24] Mr. Timm did not receive confirmations of trades made in March 1979, until June 1979.

On June 24, 1980, Schmidt requested a $60,000 ordinary loss and a $75,000 short-term capital loss for 1980. On his 1980 return, Mr. Timm claimed a $62,004 ordinary loss and a net $77,611 short-term capital loss. Mr. Timm paid to First Western $17,550 in 1980. He also deducted $844 as "First Western Gov-Sec-Counsel" and $6,750 as "investment council [*sic*]." For 1981, Mr. Timm paid to First Western $8,500, requested an $85,000 ordinary loss, and claimed an ordinary loss of $84,523. First Western's records show that Mr. Timm assigned his First Western contracts to National Mortgage on March 10, 1982. Mr. Timm did not execute the assignment contract until March 25, 1982. Mr. Timm loss money in his dealing with First Western.

Ames

Petitioner Ames was introduced to First Western by John Burns and was a successful participant in First Western's program. As with Messrs. Timm, Womble, Lewis, Harby, and Poulos, Mr. Ames' knowledge of First Western's program was, at best, sketchy, and he relied on Mr. Burns. On November 20 and 27, 1979, Mr. Ames paid a total of $260,000 to First Western and requested a $2 million ordinary loss to be converted into a long-term capital gain in 1981. Mr. Ames understood that his losses would be limited to his $260,000

[24] He also reported a short-term capital gain for transactions before that date in the amount of $46,036.

margin deposit,[25] for otherwise there "would have been a real exposure" and he "would have [had] a real problem." On his 1979 return, Mr. Ames deducted an ordinary loss of $2,029,934 and a $2,000 deduction for an investment advisory fee to Samuels-Kramer. For the year 1980, there is no record of any correspondence from Messrs. Ames or Burns to First Western. Notwithstanding this, transactions with First Western continued in which Ames received losses.

For the taxable years 1980 through 1983, the following net transactions were reported on the tax return:

Stipulation No.	*Amount*	*Type*
1980		
849	$9,422,948	Ordinary income
865	(10,218,545)	Ordinary loss
878	697,994	Ordinary income
880	(22,092)	Ordinary loss
886	(26,700)	Ordinary loss
Total	(146,395)	Ordinary loss
1981		
898	566,331	Ordinary income
901	(571,418)	Ordinary loss
905	(422,647)	Ordinary loss
Total	(427,734)	Ordinary loss
1982		
920	722,707	Long-term capital gain
928	(307,245)	Long-term capital loss
Total	415,462	Long-term capital gain
1983		
935	5,602,206	Long-term capital gain
935	(3,294,181)	Short-term capital loss
Total	2,308,025	Long-term capital gain

[25] A letter from Sidney Samuels to a Dr. Redy, a non-test case First Western customer, makes it clear that First Western's policy was to limit losses to the client's margin deposit. "To summarize, the *maximum* cash loss you will sustain in the combined First Western Government Securities, Inc./Conti Commodity Services, Inc. program is $5,000 in 1978 and $5,000 in 1979. Samuels & Co. and First Western Government Securities, Inc. will hold you harmless for any losses in excess of the above."

On February 26, 1982, Mr. Ames executed an "assignment" of various First Western contracts, having settlement dates of March 26, 1982, to Ionian and his account was credited with $726,376 from Ionian. This transaction was somewhat shrouded by the paperwork. There is nothing in the record to indicate that First Western "approved" the assignment at the time. On November 12, 1982, Ionian wrote to First Western that some assignors had not completed their paperwork. First Western sent a copy of this letter to Mr. Ames and requested that he execute the completed assignments. The assignment forms were sent on December 12, 1982, to Mr. Burns. On the same date, however, First Western wrote to Mr. Ames acknowledging assignments under the same terms as the February 26th, assignment.

Wilhide Corp.

Wilhide Corp. (Wilhide) is engaged in designing and furnishing offices. Wilhide is on a fiscal tax year ending February 28. In February 1980, Wilhide, by its president, Conrad Keado, paid First Western $81,250. Wilhide requested an ordinary loss in the amount of $625,000. On February 13, 1980, Wilhide purchased from and sold short to First Western various forward contracts for GNMAs among which were:

Purchase	GNMA 9.50%	6/17/81	$7,700,000
Purchase	GNMA 8.25	6/17/81	6,800,000

On February 19, 1980, these contracts were canceled with a loss of $676,685 that Wilhide deducted on its fiscal year tax return. After the close of its taxable year, there was no record of any correspondence between Wilhide and First Western during its 1981 fiscal year. On March 6, 1980, Wilhide had other purchase and short sale transactions with First Western with settlement dates after February 28, 1981. On March 3, 1981, Wilhide purchased $11,400,000 GNMA 11 percent, settlement 9/15/82, and sold $1,200,000 GNMA 10 percent, settlement date 4/21/82. The same day various contracts expiring in 1981 were "canceled" with a resulting gain in the amount of $23,619. These later transactions were "voided" on March 13, 1981. That same day, another group of contracts, including some contracts canceled on March 3, 1981, were canceled with a resulting loss of $441,570 that was deducted on Wilhide's 1982 tax return. On March 16, 1981, Wilhide assigned contracts to National Mortgage with a resulting gain of $1,042,841 that was reported as a long-term capital gain. National Mortgage sent Wilhide a check for $1,042,841. Wilhide endorsed this check to First Western. First Western wrote a check to National on March 18, 1982, for $1,049,677. First Western's records indicate that $6,836 was due National Mortgage. Wilhide never changed its original interest rate forecast because "we did not follow the program as we should have."

Freytag

Mr. Freytag is a lawyer who specializes in tax aspects of real estate transactions. Mr. Freytag, and at least one of his partners, decided to invest in First Western's program. Mr. Freytag's law firm became a "finder" and introduced at least 18 clients to First Western and was paid approximately $120,000 by First Western. The fees with respect to Mr. Freytag's account were not reported by the firm but applied to the account

expenses, and the firm gave the balance to Mr. Freytag. Mr. Freytag did not reduce the amount of his losses or otherwise report these amounts.

The record does not reveal the amount of loss requested in 1978. For later years, Mr. Freytag, or his agent, requested the following:

	Short-term capital loss	*Ordinary loss*
1979	$70,000	$100,000
1980		100,000
1981		130,000
1982		140,000

The ordinary losses were to be converted into long-term capital gains in subsequent years. Mr. Freytag reported on his tax returns the following:

	Short-term capital loss	*Ordinary loss*
1978		$70,539
1979	[26] $112,308	99,403
1980	[27] 3,000	101,794
1981		[28] 162,216
1982		143,001

Mr. Freytag sent First Western checks as follows:

Nov. 3, 1978	[29] $7,000
Oct. 12, 1979	[30] 11,500
Oct. 21, 1980	10,000
Feb. 18, 1981	30,000
Apr. 2, 1982	10,000
June 22, 1982	10,000

[26] Used to offset gain of $106,005.

[27] Carried over from 1979 from First Western transactions.

[28] Mr. Freytag claimed an ordinary loss in the amount of $126,188.

[29] There were two checks — one payable to First Western for $2,000 and another payable to ContiCommodity for $5,000.

[30] $4,174 was also transferred from Conti/Commodity.

Mr. Freytag's account with First Western is noteworthy in that his account frequently showed a deficit balance — i.e., Mr. Freytag owed First Western substantial amounts of money. While First Western sent letters requesting additional funds or "margin," Mr. Freytag never satisfied these requests. Nonetheless, First Western did not close his account nor did it close his positions. Indeed, First Western allowed Mr. Freytag to increase his risk to $15,000 per point, when he had a negative account value of $35,864, and to $25,000 per point, when he had a negative account value of $97,117. A letter written by Mr. Freytag to First Western, apparently in 1978, explains:

> You agree with the undersigned that the grant power [of attorney] creates the duty on your part to liquidate the account of the undersigned whenever market conditions threaten losses in excess of the margin deposits in those accounts. In the event of market conditions adverse to the positions taken by me, you hereby assume the responsibility of liquidating my account prior to the accrual of losses in excess of the amounts of margin I may elect from time to time to deposit with you, plus the amounts of gains then accrued to the open positions in my account; any losses in excess of such total shall be solely your responsibility * * * .
>
> If the foregoing correctly sets forth your understanding * * * please indicate such by executing the enclosed copy * * *

The understanding was accepted by Sidney Samuels on behalf of First Western.[31]

[31] Compare Mr. Freytag's testimony:

QUESTION: At the time you invested in the 1978 program that the most you could lose would be the amount of cash you put up?

Maule

Mr. Maule is an officer and principal owner of a furniture manufacturing company. Mr. Maule was introduced to the First Western program by Dave Kobsev, about whom he knew virtually nothing. He understood that a $100,000 loss could be realized in 1980, the account would be "neutralized" in 1980 — i.e. "I would not be at risk," and a capital gain would be reported in 1982. In Mr. Kobsev's presentation of a "worst case" situation involving First Western transactions, there was no indication that Mr. Maule could lose more than his original margin, and Mr. Maule believed that his potential loss was so limited.

For the taxable year 1980, Mr. Maule requested a $100,000 ordinary loss. On June 23 and 27, 1980, a series of forward contract transactions were entered into that culminated in one $4,200,000 contract being canceled with a $117,642 loss. That loss was deducted on Mr. Maule's 1980 return. On July 7, 1980, two weeks after the initial transactions, First Western deposited a check from Mr. Maule in the amount of $13,000.

In 1981, a request was made for a loss of $100,000. Mr. Maule's statement showed that the value of his account on February 27, 1981, was $5,719. Nonetheless, by letter dated March 2, 1981, First Western wrote to Mr. Maule advising that "your account requires an additional margin of $7,300. Please send us a check for the above amount by June 1, 1981." By a series of forward contract transactions, on March 3, 1981, Mr. Maule's account showed a loss of $106,848 by cancellations that Mr. Maule deducted as an ordinary loss on his 1981

ANSWER: [Mr. Freytag]: So that the margin was the limitation on my losses?
QUESTION: Right.
ANSWER: No.

Mr. Freytag explained that he viewed his 1978 letter as "a stop loss order." That letter, however, was explicit — "any losses in excess of * * * [the margin plus gains] shall be solely your responsibility."

return. First Western records show that the account was "neutralized" on March 23, 1981. On April 30, 1981, the account had a value of $3,721. On May 13, 1981, First Western wrote a virtually identical letter to the March 3 letter requiring a $7,300 "margin" deposit. On May 28, 1981, First Western received a check for $7,300. Mr. Maule admitted that when the facts are examined "In retrospect, it very well could have been" that the margin call was for the 1981 tax "writeoff."

McCoin

Mr. McCoin is an investment banker who, through three entities, as involved with the First Western program. McCoin owned a 50-percent interest in Mosher, McCoin & Sims (Mosher), a joint venture that has the attributes of a partnership for tax purposes. Mosher entered into a customer's agreement with First Western in June 1980. First Western's records show that a request was made for a $100,000 ordinary loss in 1980 and a $100,000 long-term capital gain for 1982. On June 24, 1980, First Western established a straddle in First Western's GNMA forward contracts for Mosher. On June 27, 1980, contracts were canceled with a loss of $102,272. On July 11, 1980, First Western received an "interest forecast" and a check for $10,000. McCoin deducted his aliquot part of this loss on his 1980 return.

In 1982, after other transactions in 1980 and 1981, Mosher "assigned" its remaining contracts to Ionian. By letter dated March 25, 1982, First Western acknowledged Mosher's assignment request as of March 10, 1982, and requested that Mosher execute and return an assignment agreement. Apparently, Mosher failed to execute the agreement and, on September 13, 1982, First Western wrote to Mosher and again requested an executed assignment agreement. A form assignment, dated March 10, 1982, was executed at some point in time by which

Mosher "assigned" its remaining contracts to Ionian. Mosher had a $90,822 profit on the assignment, and McCoin reported a long-term capital gain on his 1982 return.

McCoin, however, had two other contacts with First Western. First, he was a partner in Money Managers Joint Venture (MM). MM was formed on November 20, 1980. On December 2, 1980, MM entered into an agreement with First Western. First Western received a request for an ordinary loss of $523,000 for 1980, and a $523,000 long-term capital gain in 1982. On December 10, 1980, MM entered into a straddle of First Western's forward contracts for GNMA's. On December 11, 1980, contracts were canceled with a loss of $388,674. Also, on that date, First Western received checks in the amount of $40,500. One check for $[illegible]0 was returned for insufficient funds. The amounts of these checks correspond generally to the contributions of capital in MM required by the agreement. Before December 31, 1980, First Western received an additional $44,750 in checks — one of which for $3,000 was returned for insufficient funds. The checks that were returned apparently were never made good. Again these checks correspond to the agreed capital contributions in the partnership agreement. McCoin deducted $59,706, his aliquot share of MM's loss, on his 1980 tax return. Another series of First Western forward contracts transactions culminated in a net loss of $141,979, and McCoin deducted a net loss of $16,759 on his 1980 return. MM's total payment, after allowance for returned checks, was $73,250, and the total "trading" loss was $530,653. For the year 1981, MM requested an ordinary loss of $260,000 with a long-term capital gain in 1983 in the same amount. MM recognized a loss of $268,713 from cancellations in 1981, and McCoin deducted his share of the loss. In 1982, MM "assigned" contracts to Ionian on March 10, 1982, and its First Western account was credited with $801,719. By letter dated March 25, 1983, First Western advised MM that its gain

was $609,047, and McCoin reported a long-term capital gain of $94,631. He also reported an ordinary loss of $4,634 and ordinary income of $199.

McCoin's other connection with First Western was Mosher, McCoin & Sims, Inc. (the corporation), of which he is an owner and an employee. The corporation holds itself out as an "independent investment advisor under the provisions of section 203 of the Investment Advisors Act of 1940." During the years in question, the corporation was paid around $600,000 by First Western for putting its customers in First Western programs. The corporation prepared various presentations of the First Western program for its customers in which it was pointed out that, even if the customer lost his entire margin, he would make a profit from tax savings. The following statement was made by the corporation: "Cash deposit 17% of writeoff should expect to lose all of cash deposit any profit left at end of transaction is 'gravy.'" There is no mention in any of the corporation's materials that a customer could lose more than his payments to First Western. Mosher, McCoin and Sims had reviewed a pamphlet prepared apparently in 1978 by First Western (Samuels & Co.) that provided, inter alia:

> One time margin equal to 10% of the tax writeoff***
>
> * * * * *
>
> No other cash or margin deposits are required.
>
> * * * * *
>
> If customer is correct in his interest rate direction, he will receive a check from First Western in an amount of up to 60% of his initial margin * * *. Note that the tax write-off could be as high as 25 to 1.

ULTIMATE CONCLUSIONS OF FACT

(1) The transactions between First Western and its customers were illusory and fictitious and not bona fide transactions.

(2) Even if the transactions were bona fide transactions, the transactions were entered into primarily, if not solely, for tax-avoidance purposes.

(3) Petitioners claiming deductions based on these transactions are liable for additions to tax under section 6653(a).

OPINION

1. *The transactions were not bona fide.*

Section 165(a) allows deductions for "any loss sustained during the taxable year and not compensated for by insurance or otherwise." Deductions, in the case of an individual taxpayer, are limited, inter alia, to "loss[es] incurred in any transaction entered into for profit, though not connected with a trade or business." The regulations provide that "To be allowable as a deduction * * *, a loss must be evidenced by a closed and completed transaction * * *. Only a bona fide loss is allowable. Substance and not mere form shall govern in determining a deductible loss." Sec. 1.165-1(b), Income Tax Regs.

In examining the tax aspects of straddles of futures or forward contracts for commodities or for financial instruments, this Court has observed two situations. In those cases where the transactions take place on regulated markets, our attention has focused on the profit motive of the participant. E.g., *Smith v. Commissioner*, 78 T.C. 350, 390-394 (1982), affd. without published opinion 820 F.2d 1220 (4th Cir. 1987); *Fox v. Commissioner*, 82 T.C. 1001 (1984). On the other hand, where the market is limited to transactions between the straddle customers an the maker of that market, referred to herein as "off mar-

ket,"[12] we have focused first on whether the purported transactions existed in substance and were not merely a paper trail for tax deductions. E.g., *Forseth v. Commissioner*, 85 T.C. 127 (1985), affd. 808 F.2d 1219 (6th Cir. 1987), affd. 810 F.2d 197 (5th Cir. 1987), affd. 813 F.2d 293 (9th Cir. 1987), affd. 800 F.2d 266 (11th Cir. 1986); *Brown v. Commissioner*, 85 T.C. 968 (1985), on appeal (9th Cir., Jan. 5, 1987, and Mar. 23, 1987). This latter question is primarily factual. *Mahoney v. Commissioner*, 808 F.2d 1219, 1220 (6th Cir. 1987), affg. 85 T.C. 127 (1985); *Enrici v. Commissioner*, 813 F.2d 293, 295 (9th Cir. 1987), affg. 85 T.C. 127 (1985). We have had before us several recent cases involving "off market" transactions of Government securities or commodities. See *Forseth v. Commissioner, supra*; *Brown v. Commissioner, supra*; *Price v. Commissioner*, 88 T.C. 860 (1987). In those three cases we found that the purported transactions were "factual shams" (*Forseth v. Commissioner*, 85 T.C. at 165; *Brown v. Commissioner*, 85 T.C. at 1000), and "fictitious, i.e., shams" (*Price v. Commissioner*, 88 T.C. at 883). In making this determination, we considered various factors such as: (1) the correlation of tax needs and the purported losses, (2) the use of "margin" requirements, (3) the methods by which the "transactions" were closed, (4) the manipulation of trading records, (5) the fact that the "dealer" was on two sides of the transaction and could execute the "transactions" at will, (6) the use of pricing formulae, and (7) the viability of the dealer's "hedging" program.

More than half of the transcript in this case involves expert testimony concerning the theoretical viability of First Western's program as a bona fide investment strategy and the reasonableness of its prices for forward contracts. In many instances,

[12] By using the term "off market" we are not referring to over-the-counter markets. Rather, we are referring to alleged markets where prices are not quoted to the public.

we have no reason to doubt the general testimony of petitioners' experts. On the other hand, we are left with the very firm impression that petitioners' expert witnesses were either not given the total facts or ignored many of the gremlins in the First Western program. There, perhaps, is not a single salient gremlin that alone leads us to conclude that the transactions of First Western's world were illusory and fictitious. Rather, it is the cumulation of simply too many gremlins.

Risk of Profit and Loss

First Western was continually on all sides of these transactions. In a transaction involving the purchase or sale of forward contracts, First Western was on the opposite side, it was the market maker and it represented purchaser or seller — its customer. First Western also established the prices. Furthermore, at will, it could change positions in the portfolios. These aspects may not be necessarily fatal to the alleged bona fides of these transactions, but they do cause misgivings, particularly where only approximately 3 percent of the accounts made money, and of this group, First Western employees were the largest winners.[13]

Petitioners presented voluminous expert testimony on the profit potential of the program. But what concerns us is that, if the profit potential was not a legerdemain, why were potential losses of customers limited to the amount of margin payments.[14] In short, we are asked to believe that, while customers' losses

[13] At trial there were objections by petitioners to the testimony concerning First Western's employees as winners. We first note that we requested that the parties brief the issues. Petitioners have not addressed these objections on brief and, therefore, we assume that the objection is waived. Furthermore, after a review of these objections, we believe that they are without merit.

[14] First Western employees testified that there was no such agreement with customers. Petitioner Freytag's letter to First Western and First Western's pamphlet to McCoin put an end to that charade.

were limited, their profits were unlimited. The wearing of judicial robes does not require that we take leave of commonsense. If First Western controlled losses by its system, that system also would have to control profits, and, as Mr. Taylor's letter to Dr. Womble indicates, First Western could fine-tune its program to reach any result.

Petitioners' portfolios were constructed so as to achieve their desired tax losses. In this regard, the most important required data supplied by petitioners were their requested tax losses. Indeed, the program could not be implemented without the tax information. Thus, in analyzing the program from a profit standpoint, from the first, the tax tail wagged an economic dog. Furthermore, First Western's uncanny ability to produce almost precise tax results belies the image that the program was not capable of carefully controlling results.

Petitioners rely on the fact that certain customers, other than First Western employees, did make money, to argue that the potential for profit, therefore, was real. We believe, however, that the few cases where customers received more than they put in were simply "window dressing." Even in so-called "Ponzi" schemes there are some winners. See *Murphy v. Commissioner*, 661 F.2d 299 (4th Cir. 1981), affg. a Memorandum Opinion of this Court. But that fact does not give any economic substance to the scheme.

Hedging

Also crucial to First Western's image as a market "dealer" was its alleged hedging system. First Western allegedly maintained a hedging account with Conti. But we find little, if any, correlation between that account and First Western's alleged risk exposure through its forward contracts. Indeed, on at least one occasion, First Western "hedged" the wrong way. Putting aside First Western's method of computing its risks, which is in itself suspect, not even petitioners' primary expert on hedging

would conclude that the hedging program was operated in a manner that was consistent with sound business practices.[15] Needless to say, respondent's expert witnesses were even less enthusiastic concerning the sound business practice of First Western's hedging program. We recognize that bona fide dealers may make a decision to be exposed by not being fully hedged. But in those situations, there is a conscious decision by management to take such a risk. Here the risk was already controlled, and First Western's account with Conti was not a bona fide hedging account.

Margins and Fees

First Western's methods of using margins and collecting fees, when compared with normal practice, can only be characterized as bizarre. Essentially, the amount of the margin was determined by the tax loss requested. It was not a good-faith deposit to protect a dealer against loss. Rather, it was the source from which fees were charged. First Western's internal documents show that fees were budgeted or deducted from the margin accounts prior to any trading activity, and, when the "fee cap" was reached, no further fees were collected regardless of the number of subsequent transactions. Furthermore, as we have found, the amount of the margin limited the customers' potential losses. Finally, even when "margin calls" were made, they were frequently ignored, except when another program for the next year was started, and then the "margin calls" were, as Mr. Maule recognized, nothing more than a device used to implement the subsequent year's "tax preference."

---

[15] Petitioners' expert later expressed the view that in light of First Western's capital structure in March 1981 of $17 million, First Western's risk was not unacceptable. While at that particular time the risk compared to capital might have been reasonable, that does not explain the reasonableness of the risk before and after that period when the capital was substantially less and the risk exposure just as great. We do not find this latter testimony persuasive. Even a blind squirrel may find a nut now and then.

Pricing

An enormous amount of testimony of the experts focused on the prices of First Western's forward contracts. One aspect of the pricing is clear — the prices were artifically generated by the pricing algorithms. This point is not in dispute. Petitioners contend, however, that even if the prices are artificially generated, they should be recognized as "valid" because they closely approximated market prices.

Here, not unlike Macduff, we were "Laid on." Petitioners introduced a vast amount of testimony and studies tending to show that First Western's prices were reasonable. These studies were primarily based on regression analyses to product standard deviations between First Western's prices and the Telerate and/or Wall Street Journal prices. Respondent's experts, on the other hand, primarily based their studies on absolute price differences between First Western generated prices and the Telerate and/or Wall Street Journal prices. We are persuaded that respondent's analyses are more meaningful. A brief example is sufficient to illustrate our reasoning. If there are two observations of price differences, one of which is $10 too high and the other $10 too low, the standard deviation (or "r^2") would be zero, suggesting that First Western's pricing was accurate, even though there are vast differences in the prices. In short, in a standard deviation analysis, overpricing by the algorithm is offset by underpricing. Accordingly, we find that the absolute (or mean absolute) difference analyses by respondent more accurately reflect the reasonableness of First Western's prices.

Without going through each study, one of the most significant aspects revealed is that the algorithm systematically overpriced lower coupons and underpriced higher coupons. (Indeed, petitioners' evidence confirms this aspect of the pricing algorithms, although the price differences are not as dramatic

under petitioners' regression analyses.) Furthermore, respondent's analyses of First Western pricing showed, inter alia, cash price differences for coupons priced using First Western's algorithm and Telerate historical prices as large as $6.73, and 580 cases (24 percent of the observations) the differences were $4 or more. A comparison of First Western generated prices and Telerate prices for 1- through 4-month forward contracts was equally off the mark.

These differences are highly significant. Given the enormous legs of the straddles, if one leg is overpriced or underpriced, the gain or loss may be clearly controlled. Having written the pricing algorithms, First Western surely understood their mathematical properties, and, therefore, could, and did, utilize its prices to obtain any result it desired. This certainly is consistent with the bizarre operations of the so-called hedging account and First Western's ability to limit losses. It also explains the reason that First Western could not, and did not, quote prices to bona fide dealers. In a sentence, if it had, it would have been arbitraged out of existence by a dealer purchasing or selling at these prices and taking the opposite position in the cash market.[36]

Closing the Transactions

Petitioners used three methods of closing its customers' transactions — cancellation, setoff, and assignments. We are primarily concerned with the use of cancellation and assignments, since these devices were used by First Western to create the tax benefits its customers sought. As we have found, First Western's uses of these devices were far different from those in the "real world."

[36] While there was a sharp dispute as to the appropriate band of arbitrage — viz. when the spread between prices is arbitragable — differences of over $2 clearly fall without that band.

The manner in which the assignments were effected also reveals the nature of these transactions. The customer "assigned" his contracts to one of the three assignees. In essence, his account was credited with approximately 99 percent of the net value of the contracts. The assignee's account was credited with the full value of the contracts and debited by the amount paid to the assignor. First Western then cancelled or set off the contracts and paid the assignee approximately 1 percent of full value. There was no negotiation over prices at the time of the assignments, cancellations, or setoffs. The prices were set by First Western all the way through, even though the assignees were allegedly purchasing the contracts that provided for delivery to or from the customers. There is clearly more than a touch of whimsy in these transactions.

There are also other gremlins in First Western's program that dispel the notion that these transactions were bona fide — e.g., reversing transactions months later, assignments and confirmations being sent months after the transactions allegedly took place, margin demands not being satisfied, transactions being entered into without any documented correspondence with the customer or his representative, etc. While petitioners' experts have attempted to cast some of these facts in terms of "normal market" glitches, we are not persuaded. Perhaps, taken in isolation, there may be some validity to the explanations, but, taken together, First Western's operation could not have existed if there had been any real economic substance to its program. In short, petitioners ignore what happened and depend on a thoretical justification of what did not happen. First Western's world consisted of a computer spitting out paper showing huge transactions that had no economic significance except in petitioners' attempts to raid Federal and State fiscs.

2. *Even if there were bona fide market transactions, those transactions were not entered into primarily for economic purposes and are not recognized for Federal tax purposes.*

While we could stop here, there is an alternative basis for rejecting petitioners' claims. Section 165(c)(2) permits individuals to deduct losses incurred in any transaction entered into for profit. In *Glass v. Commissioner*, 87 T.C. 1087 (1986), we discussed in detail the background that gave rise to the theoretical basis for favorable treatment of trading straddles, and we will not repeat that discussion here. We summarized our views as follows (87 T.C. at 1175):

> Section 165 allows us a deduction any loss sustained during the taxable year and not compensated by insurance or otherwise. Section 1234 determines the character of gains and losses attributable to option transactions, including commodity options. New section 108(a) allows losses sustained by investors in straddle, transactions if incurred in a transaction entered into for a profit. * * *

"New section 108(a)" refers to section 108 ("old section 108") of the Tax Reform Act of 1984 (Division A of the Deficit Reduction Act of 1984, Pub. L. 98-369, 98 Stat. 494, 630), as amended by section 1808(d) of the Tax Reform Act of 1986, Pub. L. 99-514, 100 Stat. 2817.

Prior to section 108 of the 1984 Act ("old section 108"), the Court had found that there were not any non-tax profit objectives in transactions involved in so-called "butterfly" straddles and held that the taxpayers did not have the requisite economic profit objective necessary to enable them to deduct the commodity tax straddle losses" under section 165(c)(2). *Smith v. Commissioner*, 78 T.C. at 394. Subsequently, we held

that under section 165(c)(2) the proper test was whether the taxpayer's "primary" motive was economic, except where the "transactions * * * are unmistakably within the contemplation of congressional intent" to encourage such investments. *Fox v. Commissioner*, 82 T.C. at 1021.

We next considered the effect of "old section 108" in *Miller v. Commissioner*, 84 T.C. 827 (1985), on appeal (10th Cir., Nov. 20, 1985). In *Miller*, we recognized that the transactions were "primarily tax motivated." 84 T.C. at 837. Nonetheless, the Court held that section 108(a)[17] "directs that losses be allowed on the disposition of a position if that particular straddle transaction can be said to have held 'a reasonable prospect of any profit' at the time the straddle was acquired." 84 T.C. at 842.

Section 1808(d) of the 1986 Act[18] amended "old section 108." In *Glass v. Commissioner*, 87 T.C. at 1167, we summarized the amended version of section 108:

[17] SEC. 108(a) GENERAL RULE. — For purposes of the Internal Revenue Code of 1954, in the case of any disposition of 1 or more positions —

(1) which were entered into before 1982 and form part of a straddle, and

(2) to which the amendments made by title V of the Economic Recovery Tax Act of 1981, do not apply.

any loss from such disposition shall be allowed for the taxable year of the disposition if such position is part of a transaction entered into for profit.

(b) PRESUMPTION THAT TRANSACTION ENTERED INTO FOR PROFIT. — For purposes of subsection (a), any position held by a commodities dealer or any person regularly engaged in investing in regulated futures contracts shall be rebuttably presumed to be part of a transaction entered into for profit.

[Tax Reform Act of 1984, Pub. L. 98-369, sec. 108, 98 Stat. 630.]

[18] Sec. 1808(d) of the Tax Reform Act of 1986 amended sec. 108 as follows:

(d) SECTION 108. — Section 108 of the Tax Reform Act of 1984 is amended —

(1) by striking out "if such position is part of a transaction entered into for profit" and inserting in lieu thereof "if such loss is incurredc in a trade or business, or if such loss is incurred in a transaction entered into for profit though not connected with a trade or business,"

(2) by striking out subsection (b) and inserting in lieu thereof the following:

In summary, then, amended section 108 traces the pattern of the loss provisions of section 165(c)(1) and (2), and makes it clear that losses incurred by commodities dealers trading in commodities are deductible under section 108 since they are losses incurred in a trade or business. Investors, on the other hand, must meet the test of loss incurred in a transaction entered into for profit. In the context of commodity straddle transactions, the investor language parallels the section 165(c)(2) language which we construed in *Smith* and *Fox*, and (except as to commodities dealers) we think the effect of amended section 108 is to revalidate our holdings in those cases.

"(b) LOSS INCURRED IN A TRADE OR BUSINESS. — For purposes of subsection (a), any loss incurred by a commodities dealer in the trading of commodities shall be treated as a loss incurred in a trade or business.",

(3) by striking out the heading for subsection (c) and inserting in lieu thereof the following:

"(c) NET LOSS ALLOWED. — ",

(4) by striking out subsection (f) and inserting in lieu thereof the following:

"(f) COMMODITIES DEALER. — For purposes of this section, the term 'commodities dealer' means any taxpayer who —

"(1) at any time before January 1, 1982, was an individual described in section 1402(i)(2)(B) of the Internal Revenue Code of 1954 (as added by this subtitle), or

"(2) was a member of the family (within the meaning of section 704(e)(3) of such Code) of an individual described in paragraph (1) to the extent such member engaged in commodities trading through an organization the member of which consisted solely of —

"(A) 1 or more individuals described in paragraph (1), and

"(B) 1 or more members of the families (as so defined) of such individuals.", and

([5]) by striking out subsection (h) and inserting in lieu thereof the following

"(h) SYNDICATES. — For purposes of this section, any loss incurred by a person (other than a commodities dealer) with respect to an interest in a syndicate (within the meaning of section 1256(e)(3)(B) of the Internal Revenue Code of 1954) shall not be considered to be a loss incurred in a trade or business.

[Sec. 1808(d), Tax Reform Act of 1986, Pub. L. 99-514, 100 Stat. 2817-2818.]

The initial question that arises under our holdings in *Smith* and *Fox* is whether these transactions were "unmistakable within the contemplation of congressional intent" for affording special tax consideration. Even if we were to accept petitioners' view of this program (which we do not), the economic raison d'etre for these transaction was to permit the customers to speculate on interest rates. But rank speculation is generally not considered the type of investment that Congress has sought to foster, and petitioners have not shown us expressions of congressional intent to encourage investments of this nature. Furthermore, we doubt seriously that Congress would ever encourage a speculative device where the primary by-product is to shift income from one year to another. Thus, under the *Smith* and *Fox* analyses, petitioners must show that their primary motivation in entering into these transactions was economic profit.

Petitioners urge that there was a profit potential here as evidenced by the fact that some of the petitioners actually made money. But the fact that there may have been winning participants does not answer the question whether the transactions were primarily entered into for profit. While the petitioners testified that their primary motive or intent was to make a profit, the documents and the parties' actions direct a different conclusion.

Petitioners focus upon First Western's promotional material and point out that the tax consequences are not mentioned. From this we are asked to minimize the role that tax considerations could have played in its customers' decisions to invest in its program. First, it is quite clear from the 1978 pamphlet given to McCoin that First Western always emphasized the perceived tax advantages. Furthermore, the promotions of the so-called finders paint an entirely different picture. In that picture, the economic potential is described by one finder as the "gravy," and generally there was no discussion of economic

gain. It was generally assumed that a customer would lose most, if not all, of his payment. Clearly, the program was sold because of its perceived tax advantages, with little or no emphasis on the economic potential.

This conclusion is reinforced by the manner in which petitioners regarded these transactions with First Western. Few, if any, petitioners had the slightest idea of the operations of the program. Dr. Womble did not even understand what he had allegedly bought and sold. Few, if any, petitioners ever attempted to check prices or could even determine whether their "interest forecast" was implemented On the other hand, all of the petitioners and their finders were acutely aware of the perceived tax benefits and the finders' analyses of potential success of the program was based on the tax benefits. Indeed, Col. Harby was so focused on the tax benefits that he eschewed a $30,000 profit to increase a tax loss.

In short, it is simply ludicrous to suggest that these petitioners had anything but a most fleeting interest in a potential economic gain. Thus, even if the transactions were market transactions, this program was driven almost exclusively, and certainly primarily, by tax considerations. Accordingly, under our holdings in *Smith, Fox,* and *Glass*, petitioners may not deduct these losses under the applicable loss provisions of the Internal Revenue Code.

3. *Deductions for amounts paid to First Western and to the "finders," and inclusion in income of "profits"*

Petitioners who claimed deductions for investment services have not shown that the amounts deducted were for services other than those related to First Western transactions. The amounts paid to First Western and to the various finders were paid to purchase perceived tax deductions and are not deductible and are not deductible under section 162 or section 212.

Brown v. Commissioner, 85 T.C. at 1000, and cases cited therein. The gains from First Western forward contract transactions reported in other years, as with the losses, are not recognized for tax purposes. To the extent, however, that any petitioners received more from First Western than they paid to First Western during the years before the Court, the excess is ordinary income. *Murphy v. Commissioner*, 661 F.2d 299 (4th Cir. 1981), affg. T.C. Memo. 1980-218.

4. *Section 6621.*

Section 6601 provides that "if any amount of tax * * * is not paid on or before the last date prescribed for payment, interest * * * [as determined by section 6621] shall be paid for the period from such last date to the date paid." Section 6621(a)(2) provides the general rule that the rate of interest for underpayments shall be the "short term Federal rate" plus "3 percentage points." In the case, however, of a "substantial underpayment attributable to tax motivated transactions" shall be 120 percent of the rate under section 6621(a)(2). Sec. 6621(c)(1). A "substantial underpayment" is an underpayment exceeding $1,000 attributable to one or more "tax motivated transactions." Sec. 6621(c)(2). "Tax motivate transactions" are defined, inter alia, as "any sham or fraudulent transaction." Sec. 6621(c)(3)(A)(v). We have found that these transactions were illusory and fictitious, i.e., shams. Accordingly, the underpayments resulting from the losses and related deductions claimed on petitioners' returns are attributable to tax-motivated transactions and the interest on these underpayments shall be computed under section 6621(c)(1).

5. *Negligence.*[39]

Section 6653(a) provides that if any part of an underpayment "is due to negligence or intential disregard of rules and regulations (but without intent to defraud), there shall be added to the tax an amount equal to 5 percent of the underpayment." Petitioners have the burden of proving that their actions in claiming these losses were not negligent. *Forseth v. Commissioner*, 85 T.C. at 166.

"Negligence is a lack of due care or the failure to do what a reasonable and ordinarily prudent person would do under the circumstances." *Marcello v. Commissioner*, 380 F.2d 499, 506 (5th Cir. 1967), affg. on this issue 43 T.C. 168 (1964); T.C. Memo. 1964-299, cert. denied 389 U.S. 1004 (1968); *Zmuda v. Commissioner*, 731 F.2d 1417, 1422 (9th Cir. 1984), affg. 79 T.C. 714 (1982).

In these cases, all petitioners had backgrounds and knowledge that should have alerted them to the fact that something was wrong with First Western's program. While their vocations varied, all petitioners had some business and/or investment background, and there were clearly sufficient gremlins that would have required a reasonably prudent person to step back and take another look. We do not find any attempt by petitioners Ames, Timm, Poulos, Lewis, and Womble to take even the most elementary steps to investigate. They were told about the perceived tax advantages that, especially when compared with the payment, were enormous. As we have noted in our findings that fact, these petitioners then entered into the alleged transactions with little or no understanding of what they were doing, even though, if we accept the literal terms of the forward contracts, they could be required to make or receive delivery of

[39] Additions to tax under sec. 6653(a) were determined against petitioners Freytag, Timm, Poulos, Lewis, Ames, Womble, and McCoin.

millions of dollars of GNMA's and FMAC's. Furthermore, this was during a period of time when, as the Ninth Circuit has observed, there was "extensive continuing press coverage of questionable tax shelter plans." See *Zmuda v. Commissioner*, 731 F.2d at 1422, and references cited therein.

Petitioners Ames, Poulos, Timm, Lewis, and Womble, however, contend that they satisfied the reasonable and prudent person standard by relying on the advice of their investment counselors. We are not persuaded. While there are situations where reliance on expert advice may satisfy this standard, these petitioners do not fall within that rationale. Reliance on professional advice, but rather a factor to be considered. First, it must be established that the reliance was reasonable. There is no showing that petitioners were negligent in relying on the advice given by attorneys or certified public accountants with respect to the tax consequences of the transactions at issue if they had substance. However, there is also no showing that petitioners consulted any experts with respect to the bona fides of the financial aspects of the transactions. One of the attorneys (Mr. Taylor) giving tax advice specifically testified that he was "no expert" on such matters, and we believe that, if he had known the facts, he would not have given the advice that he did. Moreover, his client testified that he had no knowledge that Mr. Taylor had experience or expertise in this area. Similarly, while Mr. Burns was a CPA, he had no market experience upon which to base an opinion that Mr. Ames could reasonly rely on. There is nothing in the record to indicate that Messrs. Neese or Schmidt had any expertise in this area. Taking into account the novel nature of First Western's program and the huge tax writeoffs, we believe further investigation was mandated.[40] See *Saviano v. Commissioner*, 765 F.2d 643, 654 (7th

[40] Messrs. Taylor and Burns testified that they solicited the views of other professionals concerning First Western. We do not know, however, if this was communicated to their clients, nor do we know the particular expertise of the persons contacted.

Cir. 1985), affg. 80 T.C. 955 (1983). We also recognize that many people make investments on the touts of even strangers, but, simply because many people do, does not establish reasonable and prudent conduct. In short, if there had been any real examination of the program, "No reasonable person would have expected this scheme to work." Compare *Hanson v. Commissioner*, 696 F.2d 1232, 1234 (9th Cir. 1983), affg. a Memorandum Opinion of this Court. Accordingy, petitioners Ames, Timm, Poulos, Lewis, and Womble have not carried their burden of proof on this issue.

All that we have said also applies to Messrs. Freytag and McCoin; however, both petitioners face additional problems. Mr. Freytag, while perhaps not professionally concentrating on the tax aspects of securities transactions, certainly was no stranger to the tax laws. He was informed about First Western by some of his law partners and allegedly "did some research as to the investments." He knew that the so-called "margin" was a charade. The only conclusion that is possible on this record is that Mr. Freytag knew that First Western's program was controlled to the point that any meaningful risk was virtually nonexistent, and, therefore, these could not have been bona fide transactions. Nonetheless, he filed returns claiming losses based on this program. Warning bells tolled, but he ignored them. Mr. Freytag's actions were, at the very least, negligent.

Mr. McCoin's situation is somewhat similar. Mr. McCoin has degrees in finance and economics. He also knew that any risk was limited to the "margin" and that the "margin" was geared to the tax loss requested. Thus, he must have known that First Western's program depended on controlled results with only a vague reference to market forces. As with Mr. Freytag, with Mr. McCoin's background, the warnings bells surely rang loud and clear and he ignored them. Both had to know that the investment was simply too good to be valid taxwise.

6. *Section 6673 and Rule 33(b).*

Section 6673 provides that if "it appears to the Tax Court * * * that the taxpayer's position in * * * proceedings is frivolous or groundless, damages in an amount not in excess of $5,000 shall be awarded to the United States." In *Brown v. Commissioner*, 85 T.C. at 1002, while we eschewed awarding damages, we stated:

> We hereby serve notice, however, that henceforth we will have no reluctance with respect to petitioners who file petitions or maintain positions based upon transactions which they knew or reasonably should have known to be factual shams.

We have found, inter alia, that the transactions here were essentially illusory and fictitious, similar to those in *Brown*, and we are tempted to award damages. As discussed in the previous section of this opinion, there clearly were warning bells that any reasonable and prudent person should have heard. In the exercise of our discretion, however, we will again eschew awarding damages even though these cases are nothing more than variants of *Brown*.

There are, however, other groups of cases involving similar types of transactions that may fall either within the factual patterns of this case and *Brown* or the *Glass* case. We serve notice, therefore, that the cases addressed in this opinion are the last free bites of that apple.

We also caution future counsel that Rule 33(b) provides:

> The signature of counsel or a party constitutes a certificate by him that he has read the pleading that, to the best of his knowledge, information, and belief formed after reasonable inquiry, it is well grounded

> in fact, and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation. * * * If a pleading is signed in violation of this rule, the Court, upon motion or upon its own initiative, may impose upon the person who signed it, a represented party, or both, an appropriate sanction, which may include an order to pay to the other party or parties the amount of the reasonable expenses incurred because of the filing of the pleading, including reasonable counsel's fees.

We are aware that sometimes a client may insist that a case be litigated even when the chances of success are virtually nonexistent. But counsel also owes a duty to this Court. See rule 3.1, A.B.A. Model Rules of Professional Conduct and Code of Judicial Court (Aug. 1983 ed.). If tension exists between that duty and a client's insistence on litigating unmeritorious claims, counsel must evaluate Rule 33(b). Compare *Kalgaard v. Commissioner*, 764 F.2d 1322, 1324 (9th Cir. 1985), affg. a Memorandum Opinion of this Court.

Decisions will be entered under Rule 155.[41]

---

[41] While Rule 155 computations may be unnecessary in some cases, it is unclear to us whether the parties are in agreement. Accordingly, we will let the parties sort out these problems, if any.

APPENDIX TO TAX COURT OPINION

1. The deficiencies in these cases are as follows:

Docket No.	Petitioners	TYE Dec. 31 —	Deficiencies Tax	Sec. 6653(a)
4934-82	Thomas L. and	1978	$35,269.80	$1,763.49
	Sharon N. Freytag	1979	51,101.00	2,255.05
9307-82	Bert C. and	1978	17,556.00	878.00
	Mildred H. Timm	1979	15,544.00	777.00
		1980	43,518.00	2,176.00
27146-82	Horace D. and			
	Sandra S. Harby	1979	10,840.60	—
29012-82	Ernest and	1978	73,040.00	3,589.00
	Joyce Poulos	1979	100,447.00	5,022.00
		1980	84,347.00	4,206.85
1240-83	Littleton G. Lewis, Jr.	1979	8,712.00	429.00
	and Irene R. Lewis	1980	11,482.00	574.00
3250-83	Joe D. and			
	Gladys E. Womble	1980	23,334.52	1,166.73
8616-83	Gerald T. and			
	Charlene K. Maule	1980	59,208.00	—
33016-83	Horace D. and	1980	27,684.07	—
	Sandra S. Harby	1981	9,318.00	—
204-84	Gerald T. and			
	Charlene K. Maule	1981	35,895.00	—
3749-84	Thomas L. and			
	Sharon N. Freytag	1980	49,946.00	2,497.00
7658-94	B. Charles and	1979	1,028,973.70	51,448.69
	Joyce G. Ames	1980	110,994.10	5,549.71
11821-84	Kenneth G. and			
	Candace G. McCoin	1980	52,836.44	2,641.82

2. At the time of filing their petitions, petitioners resided as follows:

Petitioners	Place of residence
Thomas L. and Sharon N. Freytag (Freytag)	Dallas, Texas
Littleton G., Jr., and Irene R. Lewis (Lewis)	Greenville, South Carolina
Horace D. and Sandra S. Harby (Harby)	Clemson, South Carolina
Ernest and Joyce Poulos (Poulos)	Dallas, Texas
Bert C. and Mildred H. Timm (Timm)	Plano, Texas
Joe D. and Gladys E. Womble (Womble)	Arlington, Texas
Gerald T. and Charlene K. Maule (Maule)	Tacoma, Washington
B. Charles and Joyce G. Ames (Ames)	Shaker Heights, Ohio
Kenneth G. and Candace G. McCoin (McCoin)	Houston, Texas

3. Petitioners filed income tax returns claiming deductions attributable to transactions with First Western that respondent disallowed as follows:

Petitioner	Year	Claimed deductions	
Freytag	1978	$70,739.00	Ordinary loss from cancellations
	1979	99,403.00	Ordinary loss from cancellations
		6,303.00	Net short-term capital loss from offsets[42]
	1980	101,794.00	Ordinary loss from cancellations
Poulos	1978	152,359.00	Ordinary loss from cancellations
		7,500.00	Investment counsel fee to Interplan, Inc.
	1979	183,416.00	Ordinary loss from cancellations

[42] Only $3,000 of this amount was used in 1979 because of the limit on the use of capital losses.

Petitioner	Year	Claimed deductions	
		2,000.00	Investment advisory fee
		10,500.00	Investment counsel fee to Interplan
	1980	167,244.00	Ordinary loss from cancellations
		$7,500.00	Investment counsel fee to Interplan
Timm	1978	50,476.24	Ordinary loss from cancellations
		2,500.00	Investment counsel fee to Interplan
	1979	12,633.00	Net short-term capital loss from offsets
		1,000.00	Investment counsel fee to Interplan
		5,000.00	Investment advisory fee
	1980	62,004.00	Ordinary loss from cancellations
		77,611.00	Net short-term capital loss from offsets
		844.00	Investment advisory fee to Samuels-Kramer
		6,750.00	Investment counsel fee to Interplan
Ames	1979	2,029,934.00	Ordinary loss from cancellations
		2,000.00	Investment advisory fee to Samuels-Kramer
	1980	146,395.00	Ordinary loss from cancellations
Harby	1979	54,777.00	Ordinary loss from cancellations

Petitioner	Year	Claimed deductions	
	1980	76,624.00	Ordinary loss from cancellations
		581.00	Net short-term capital loss from offsets
	1981	33,798.00	Ordinary loss from cancellations
Lewis	1979	49,305.00	Ordinary loss from cancellations
		300.00	Investment advisory fee
	1980	37,768.00	Ordinary loss from cancellations
		529.00	Net short-term capital loss from offsets
		1,600.00	Investment advisory fee
Maule	1980	117,642.00	Ordinary loss from cancellations
	1981	106,848.00	Ordinary loss from cancellations
Womble	1980	47,367.33	Ordinary loss from cancellations
McCoin	1980	113,771.00	Ordinary loss from cancellations

APPENDIX C.

United States Tax Court.

FIRST WESTERN GOVERNMENT SECURITIES, INC., ET AL.,[1] PETITIONERS *v.* COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket Nos.	25760-84, 32276-84, 33758-84, 22524-85, 6400-86, 21748-85, 25978-86, 2786-87.	Filed April 9, 1990.

OPINION

NIMS, *Chief Judge*: These cases are before the Court on petitioners' motions to vacate the assignment of their cases to a special trial judge and to request that a Presidentially appointed Tax Court judge be assigned to consider these cases. By these motions, petitioners challenge the procedures which have been utilized by this Court for over 50 years. *See Appendix A*.

[1] For purposes of these motions, cases of the following petitioners are consolidated herewith: Sidney P. Samuels, docket No. 32276-84; Samuels, Kramer and Company, docket No. 33758-84; Sidney P. Samuels and Laurel M. Samuels, docket No. 22524-85; First Western Investments, Inc. and Subsidiaries, docket No. 6400-86; Samuels, Kramer and Company, docket No. 21748-86; Sidney P. Samuels and Laurel M. Samuels, docket No. 25978-86; First Western Investments, Inc. and Subsidiaries, docket No. 2786-87.

Respondent determined deficiencies in and additions to petitioners' Federal income taxes as follows:

				Additions to Tax — Sections			
Docket No.	Taxable Year	Deficiency	6653(b)	6653 (b)(1)	6653 (b)(2)	6661	6621 (c)
25760-84	1978	$ 6,042,502	$ 3,021,251	$ —	—	$ —	—
	1979	10,229,372	5,114,686	—	—	—	—
	1980	30,420,098	15,210,049	—	—	—	—
32276-84	1980	412,164	206,082	—	—	—	—
33758-84	1978	169,464	—	—	—	—	—
	1979	1,136,581	568,291	—	—	—	—
	1980	67,655	—	—	—	—	—
22524-85	1981	14,225,894	7,112,947	—	—	—	(2)
6400-86	1981	36,004,857	—	18,002,429	(1)	—	(2)
21748-86	1981	20,300	—	10,150	(1)	—	(2)
25978-86	1982	156,996	—	78,498	(1)	13,586	(2)
2786-87	1982	24,510,631	—	12,255,316	(1)	6,127,658	(2)

(1) 50% of the interest
(2) Interest will accrue at 120% of the normal rate

Unless otherwise indicated, all references to the Constitution are to the United States Constitution, all section references are to the Internal Revenue Code (Title 26 of the United States Code), and all Rule references are to the Tax Court Rules of Practice and Procedure.

At the time of filing their petitions, petitioners First Western Government Securities, Inc., First Western Investments, Inc. and Subsidiaries, and Samuels, Kramer and Company had their principal places of business in San Francisco, California, Reno, Nevada and New York, New York, respectively.

At the time of filing of their petitions, petitioners Sidney P. and Laurel M. Samuels were residents of San Francisco, California.

Background

Petitioners' cases raise issues similar to those raised in over 3,000 cases that have been filed in this Court. The common denominator of these cases is that each petitioner other than First Western Government Securities, Inc. (First Western) allegedly entered into financial transactions involving forward contracts for Government mortgage-backed securities with petitioner First Western.

From among the 3,000 above-mentioned cases, 12 cases (not including the cases now before us) were selected as test cases and were initially assigned by the chief judge of this Court to Judge Richard C. Wilbur. Subsequently, following Judge Wilbur's disability retirement on April 30, 1086, the cases were reassigned without objection pursuant to section 7456(d) (redesignated as section 7443A(b) by the Tax Reform Act of 1986, Pub. L. 99-514, section 1556, 100 Stat. 2755; see Appendix A) and Rule 180, to Special Trial Judge Carleton D. Powell. In due course the cases proceeded to trial and Opinion. The trial was held in San Francisco, California, and Washington, D.C., and consumed all or part of 16 weeks of trial time. Approximately 7,000 exhibits were received into evidence. On October 21, 1987, the Court agreed with and adopted the Opinion of Special Trial Judge Powell, reported as *Freytag v. Commissioner*, 89 T.C. 849 (1987). Rule 183(c); see Appendix B.

Pursuant to section 7443A and Rules 180, 181 and 183, petitioners' cases, which are part of the above-mentioned 3,000 case group, were also assigned to Special Trial Judge Powell. On October 12, 1989, petitioners filed identical motions to vacate the assignment of their cases to Special Trial Judge Powell. On January 16, 1990, respondent filed objections to the motions to vacate and memorandums of points and authorities in support of his objections. On February 15, 1990,

petitioners filed reply memorandums to respondent's objections.

These cases have been consolidated solely for purposes of considering the motions to vacate.

The Tax Court was created by Congress under article I of the Constitution and is composed of 19 judges who are appointed by the President, by and with the advice and consent of the Senate. Section 7441 and 7443(a) and (b). At least biennially, the judges of the Tax Court designate one judge to be chief judge. Section 7444(b). The chief judge may appoint special trial judges. Section 7443A(a). Special Trial Judge Powell is one of 14 current special trial judges appointed by the chief judge.

The Court takes judicial notice that as of February 28, 1990, there were 54,428 cases pending in this Court. Of this number, 37,405 cases have been identified as having tax shelter issues. Of this number, 168 groups of related cases identified as involving tax shelter issues have been assigned under section 7443A(b)(4) to Special Trial Judges. These groups encompass approximately 14,500 cases.

Petitioners object to the assignment of these cases to Special Trial Judge Powell on the grounds that (1) section 7443A does not authorize the chief judge of the Tax Court to assign these cases to a special trial judge; and (2) the Appointments Clause of the United States Constitution article II, section 2, clause 2 does not permit Congress to authorize the chief judge of the Tax Court to appoint special trial judges.

In recognition of the well-established judicial preference of avoiding a constitution ruling if an independent statutory basis for a decision is available, we will first consider whether section 7443A authorizes the chief judge of the Tax Court to assign these cases to a special trial judge.

Section 7443A

Petitioners contend that the assignment by the chief judge of these cases to a special trial judge exceeds the authority conferred on the chief judge by section 7443A (see Appendix A) because the amount in dispute in each case exceeds $10,000.

Section 7443A(b) authorizes the chief judge to assign the following proceedings to special trial judges.

> (b) PROCEEDINGS WHICH MAY BE ASSIGNED TO SPECIAL TRIAL JUDGES. — The chief judge may assign —
>
> (1) any declaratory judgment proceeding,
>
> (2) any proceeding under section 7463 [see Appendix C],
>
> (3) any proceeding where neither the amount of the deficiency placed in dispute (within the meaning of section 7463) nor the amount of any claimed overpayment exceeds $10,000, and
>
> (4) any other proceeding which the chief judge may designate,
>
> to be heard by the special trial judge of the court.

Petitioners concede that paragraph (4), when read in isolation, allows the chief judge to assign any proceeding, including the present cases, to a special trial judge. However, petitioners assert that the language "any other proceeding" in paragraph (4) is actually limited to the type of proceedings described in paragraphs (1), (2) and (3) when paragraph (4) is read in conjunction with the other provisions of section 7443A(b). Petitioners contend that unless assignments under paragraph (4) are limited, paragraphs (1), (2) and (3) serve no purpose.

Respondent contends that paragraph (4) was added to section 7443A to allow the chief judge to assign proceedings distinct from those described in paragraphs (1), (2) and (3) to special trial judges. We agree with respondent.

Petitioners rely on *Gomez v. United States*, ___ U.S. ___, 109 S.Ct. 2237 (1989), to support their contention that proceedings that may be assigned under paragraph (4) are limited to the proceedings described in paragraphs (1), (2) and (3). *Gomez* addressed the issue of whether the Federal Magistrates Act (the Act) authorized United States district courts to assign jury selection in felony trials to magistrates. The Supreme Court determined that Congress did not intend to allow district courts to assign the duty of selecting juries in felony trials to magistrates under a clause in the Act allowing "additional duties" not otherwise prohibited to be assigned.

In *Gomez*, the Supreme Court analyzed the legislative history and structure of the Act and concluded that Congress did not intend to permit jury selection in a felony trial to be assigned to magistrates under the additional duties clause. Specifically, the Supreme Court stated:

> By a literal reading this additional duties clause would permit magistrates to conduct felony trials. But the carefully defined grant of authority to conduct trials of civil matters and of minor criminal cases should be construed as an implicit withholding of the authority to preside at a felony trial. The legislative history, with its repeated statements that magistrates should handle subsidiary matters to enable district judges to concentrate on trying cases, and its assurances that magistrates' adjudicatory jurisdiction had been circumscribed in the interests of policy as well as constitutional constraints, confirms this inference. Similar considerations lead us to conclude that

> Congress also did not contemplate inclusion of jury selection in felony trials among a magistrate's additional duties. [*Gomez v. United States,* ___ U.S. ___, 109 S.Ct. 2237, 2245-2246 (1989); fn. refs. omitted.]

In contrast, the legislative history and structure of section 7443A(b) show that Congress added paragraph (4) to allow the chief judge to assign proceedings not described in paragraphs (1), (2) and (3) to special trial judges. Thus, applying the Supreme Court's analysis in *Gomez* to section 7443A(b) shows that paragraph (4) authorizes the chief judge to assign the present cases to a special trial judge.

Paragraph (4) was added to present section 7443A(b) in 1984. Prior to 1984, the chief judge was authorized to assign to special trial judges only "any declaratory judgment proceeding, any small tax case, and any other proceeding where the amount in dispute [did] not exceed $5,000." H. Rept. No. 98-432 at 1568 (March 5, 1984). These are the proceedings currently found in paragraphs (1), (2) and (3) (with the dollar ceiling raised to $10,000).

The Supplemental Report of the Committee on Ways and Means, H. Rept. No. 98-432 at 1568 (March 5, 1984), states the reasons for adding paragraph (4) and the explanation of the change as follows:

> *Reasons for Change*
>
> The committee wishes to clarify that additional proceedings may be assigned to [Special Trial Judges] so long as a Tax Court judge must enter the decision.
>
> *Explanation of Provision*
>
> A technical change is made to allow the Chief Judge of the Tax Court to assign any proceeding to a special trial judge for hearing and to write proposed opinions, subject to review and final decision by a Tax Court judge, regardless of the amount in issue. However, special trial judges will not be authorized to enter decisions in this latter category of cases.

Because the legislative history and structure of section 7443A show that Congress intended to allow the chief judge to assign any proceeding to a special trial judge, provided that a Tax Court judge review the opinion and enter the decision, petitioners' reliance on *Gomez* is misplaced.

It is important to note that at the same time paragraph (4) was added to the present section 7443A(b) Congress also amended present section 7443A(c) to provide that a special trial judge could only enter decisions in proceedings assigned under paragraph (1), (2) and (3).

Section 7443A(c) provides:

> (c) AUTHORITY TO MAKE COURT DECISIONS. — The court may authorize a special trial judge to make the decision of the court with respect to any proceeding described in paragraph (1), (2), or (3) of subsection (b), subject to such conditions and review as the court may provide.

Before 1984, the present section 7443A permitted special trial judges to enter decisions in any proceedings assigned to them. However, after Congress amended present section 7443A(c), special trial judges were limited to entering decisions in the proceedings described only in subsection (b)(1), (2) and (3).

An assignment made under subsection (b)(1), (2) or (3) differs from an assignment made under subsection (b)(4) because a special trial judge may enter the decision of the Court

in an assignment made under the former but not the latter. Furthermore, reports in cases assigned under subsection (b)(4) must be reviewed and adopted by a Presidentially appointed judge of the Court. Rule 183(c); see Appendix B. In addition, where appropriate the chief judge may direct that such report be reviewed by the entire Tax Court. Section 7460(b). Thus, petitioners' contention that subsection (b)(4) subsumes subsection (b)(1), (2) and (3) is erroneous.

Accordingly, we conclude that section 7443A(b)(4) authorizes the chief judge to assign the present cases to a special trial judge.

Appointments Clause

We next consider petitioners' contention that section 7443A(a) authorizing the chief judge of the Tax Court to appoint special trial judges is unconstitution.

Section 7443A(a) provides:

> (a) APPOINTMENT. — The chief judge may, from time to time, appoint special trial judges who shall proceed under such rules and regulations as may be promulgated by the Tax Court.

Petitioners assert that article II, section 2, clause 2 of the Constitution (the Appointments Clause) precludes Congress from vesting the authority to appoint special trial judges in the chief judge of the Tax Court.

The Appointments Clause provides:

> [The President] shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the Supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law; but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.

Officers of the United States

Petitioners first contend that special trial judges are principal officers of the United States who, under the Appointments Clause, may only be appointed by the President by and with the advice and consent of the Senate. Respondent argues that special trial judges are not principal or inferior officers of the United States, but employees of the Tax Court. Thus, respondent contends that the Appointments Clause does not in any way limit Congress' power to authorize the chief judge of the Tax Court to appoint special trial judges.

The Appointments Clause is not a discretionary provision but applies to the appointment of "all persons who can be said to hold an office under the government * * * ." *Buckely v. Valeo*, 424 U.S. 1, 125 (1976) (quoting *United States v. Germaine*, 99 U.S. 508, 509-510 (1879). However, not all employees of the government are officers of the United States. Persons who simply assist officers in discharging their duties are "lesser functionaries subordinate to officers of the United States." *Auffmordt v. Hedden*, 137 U.S. 310, 327 (1890); *United States v. Germaine*, 99 U.S. 508 (1879).

In contrast, an officer is an "appointee exercising significant authority pursuant to the laws of the United States * * * ." *Buckley v. Valeo, supra* at 126. Whether an individual is an officer rather than an employee "is determined by the manner in which Congress has specifically provided for the creation

of the several positions, their duties and appointment thereto." *Burnap v. United States,* 252 U.S. 512, 516 (1920).

The position of special trial judge was created by Congress through an amendment to the Internal Revenue Code. Section 958 of the Tax Reform Act of 1969, Pub. L. 91-172, 83 Stat. 487, 734. Special trial judges may be assigned any proceeding and may enter the decision of the Court in any declaratory judgment proceeding, any small tax case or any case in which the amount in dispute does not exceed $10,000. Section 7443A(b) and (c). Special trial judges are appointed for an indeterminate period, may be dismissed without restriction and receive 90 percent of the compensation of Presidentially appointed Tax Court judges. Section 7443A(a) and (d)(1); see *Ex parte Hennen,* 13 Peters 230, 258-259 (1839).

Because special trial judges may be assigned any case and may enter decisions in certain cases, it follows that special trial judges exercise significant authority. Thus, special trial judges are officers, not employees of the United States.

Principal and Inferior Officers

Petitioners assert that special trial judges are "principal" officers who must be appointed by the President by and with the advice and consent of the Senate. Respondent contends that the special trial judges are "inferior" officers. We agree with respondent.

"The Constitution for purposes of appointment * * * divides all its officers into two classes." *United States v. Germaine, supra* at 509. "Principal officers are selected by the President with the advice and consent of the Senate. Inferior officers Congress may allow to be appointed by the President alone, by the heads of departments, or by the Judiciary." *Buckley v. Valeo, supra* at 132.

The line between inferior and principal officers is one that is far from clear, and the Framers of the Constitution provided little guidance as to where it should be drawn. *Morrison v. Olson,* 487 U.S. 654, ___, 108 S.Ct. 2597, 2608 (1988). In determining whether a person is a principal or inferior officer, the Supreme Court has considered whether (1) a principal officer has the power to remove the officer; (2) the duties delegated are subject to limitations; (3) the jurisdiction of the office is limited; and (4) the appointment is temporary or permanent. *Morrison v. Olson,* 108 S.Ct. at 2608-2609.

The chief judge of the Tax Court, a principal officer, has the authority to appoint and remove special trial judges without restriction. Section 7443A(a); see *Ex parte Hennen, supra* at 258-259. The duties of special trial judges are defined and limited by the Order issued by the chief judge assigning a case to a special trial judge. Rules 180, 181, 182 and 183. Special trial judges may only enter the decision of the Court in declaratory judgment proceedings, small tax cases and cases in which the amount in dispute does not exceed $10,000, and in no others. Section 7443A(c).

Commissioners and magistrates serving other courts are considered to be inferior officers. *Go-Bart Importing Co. v. United States,* 282 U.S. 344, 352 (1931); *Rice v. Ames,* 180 U.S. 371, 378 (1901); *Pacemaker Diagnostic Clinic of America v. Instromedix,* 725 F.2d 537, 545 (9th Cir. 1984). We conclude that the duties and authority of special trial judges are similar to those of commissioners or magistrates.

The commissioners and magistrates in the above cases had more authority and greater protection from removal than special trial judges. Commissioners were empowered to issue arrest warrants, search warrants, and to arrest and imprison. *Go-Bart Importing Co. v. United States, supra* at 156. Magistrates may preside in any civil or misdemeanor trial with the consent of the parties. 28 U.S.C. section 636(c) (1982); 18 U.S.C. sec-

tion 3401(b) (1982). Magistrates are appointed for a term of years and can only be removed for cause while special trial judges are appointed for an indeterminate period and their employment may be terminated without cause, e.g., lack of work for them to perform, budgetary limitations, and the like. 28 U.S.C. section 631 (1982); see *Ex parte Hennen, supra* at 258-259.

Considering the limitations placed on the duties, jurisdiction and tenure of special trial judges, we conclude that special trial judges are inferior, not principal, officers of the United States.

Courts of Law

Petitioners assert that the Appointments Clause does not allow Congress to vest the authority to appoint inferior officers such as special trial judges in the chief judge of the Tax Court.

In *United States v. Germaine, supra* at 509-510, the Supreme Court stated that:

> The Constitution for purposes of appointment very clearly divides all its officers into two classes. The primary class requires a nomination by the President and confirmation by the Senate. But foreseeing that when offices became numerous, and sudden removals necessary, this mode might be inconvenient, it was provided that, in regard to officers inferior to those specially mentioned, Congress might by law vest their appointment in the President alone, in the courts of law, or in the heads of departments. * * *

Petitioners concede that Congress may vest the power to appoint inferior officers in the courts of law. However, petitioners assert that the term "Courts of Law" refers only to courts

created under article III of the Constitution. Thus, petitioners contend that because the Tax Court was created under article I of the Constitution, Congress may not vest the authority to appoint inferior officers in the chief judge of the Tax Court.

Respondent contends that the term "Courts of Law" refers to Article I as well as Article III courts, and therefore, Congress may vest the authority to appoint inferior officers in the chief judge of the Tax Court.

It is well established that the term "Courts of Law" includes Article III courts. *Morrison v. Olson*, 108 S.Ct. at 2609-2611; *Go-Bart Importing Co. v. United States, supra* at 156-157; *Rice v. Ames, supra* at 378.

The parties, however, do not cite a case addressing the issue of whether an Article I court is a court of law within the meaning of the Appointments Clause. The Court's own research has not revealed such a case. Therefore, the issue of whether an Article I court is a court of law, under the Appointments Clause, is one of first impression.

The Tax Court is a court of record established under article I of the Constitution. Section 7441. A "court of record" is generally defined as "a court that is required to keep a record of its proceedings, and that may fine or imprison." See Black's Law Dictionary, p. 319 (5th ed. 1979). We find nothing in the definition of a court of record to preclude a court such as the Tax Court from being a court of law as well.

Black's Law Dictionary, *supra* at 323, defines a court of law as follows:

> In a wide sense, any duly constituted tribunal administering the laws of the state or nation; in a narrower sense, a court proceeding according to the course of the common law and governed by its rules and principles, as contrasted with a "court of equity."

The Tax Court fits within the wide definition of the term "court of law" because it is a duly constituted tribunal administering laws of the United States.

The narrower definition of the term "court of law" implies that a court must have common law as contrasted with equitable powers to be a court of law. Whether an Article I court generally may exercise common law powers is unclear. See *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 59-60 (1982); cf. *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833, 856-858 (1986).

Petitioners assert that the language of the Appointments Clause shows that the term "Courts of Law" refers to Article III courts. Thus, the commonly accepted definition of the term "court of law" is not the relevant definition.

The portion of the Appointments Clause permitting Congress to delegate the appointment of inferior officers (the delegation clause) provides:

> but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.

Petitioners contend that using the term "Heads of Departments" in conjunction with "Courts of Law" implies that the Clause refers to the executive and judicial branches of government. See *Buckley v. Valeo, supra* at 127. Accordingly, petitioners assert that the term "Courts of Law" refers only to Article III, not Article I, courts.

The delegation clause was proposed and adopted with no debate as to the meaning of the terms "Courts of Law" or "Heads of Departments." M. Farrand, 2 Records of the Federal Convention of 1787, pp. 627-628 (1966) (see Appendix D, *infra*); see also *Morrison v. Olson*, 108 S.Ct. at 2610. Thus, whether the term "Courts of Law" was intended for some reason to refer exclusively to Article III courts cannot be determined by examining the history of the delegation clause.

In *Ex parte Hennen, supra* at 257, the Supreme Court considered the term "Courts of Law" as used in the delegation clause and stated:

> The appointing power here designated, in the latter part of the section, was, no doubt, intended to be exercised by the department of the government to which the officer to be appointed most appropriately belonged. The appointment of clerks of courts properly belongs to the courts of law; and that a clerk is one of the inferior officers contemplated by this provision in the constitution cannot be questioned. * * *

The Supreme Court read the delegation power as "intended to be exercised by the department of the government to which the officer to be appointed most appropriately belonged." Thus, the Supreme Court considered that the purpose of the delegation clause was to allow Congress to vest the authority to appoint where it "most appropriately belonged."

In *Ex parte Siebold*, 100 U.S. 371, 397 (1880), the Supreme Court expanded the meaning of the delegation clause by stating:

> It is no doubt usual and proper to vest the appointment of inferior officers in that department of the government, executive or judicial, or in that particular executive department to which the duties of such officers appertain. But there is no absolute requirement to this effect in the Constitution * * *.

The Court read the delegation clause as permitting Congress to vest the appointment power either in the particular depart-

ment to which the duties of the officer pertain or in any other department of government. Thus, it is within the discretion of Congress to decide where the appointing power should be placed. *Morrison v. Olson*, 108 S.Ct. at 2610-2611.

Congress vested the authority to appoint special trial judges in the chief judge of the Tax Court. The delegation clause was intended to allow Congress to vest the authority to appoint inferior officers in the Court to which the officer to be appointed most appropriately belonged. Thus, reading the term "Courts of Law" to exclude the Tax Court would frustrate the purpose for which the delegation clause was created.

Nothing in the cases which have interpreted the delegation clause suggests that the clause was intended to deprive Congress of the power to vest the appointment power in a lawfully created governmental body should that body not fit within the terms "Heads of Departments" or "Courts of Law" as those terms were defined when the Constitution was adopted. To the contrary, the Supreme Court has read the delegation clause as giving Congress broad discretion in vesting the appointment power where Congress deems appropriate.

Congress long authorized the former Court of Claims, when an Article I court, to appoint its own commissioners and clerk. See W. Cowen, The United States Court of Claims — A History, 216 Ct.Cl. 1, 90-95, 177 (1978). Congress permits administrative agencies to appoint their own administrative law judges who perform duties similar to those of special trial judges. 5 U.S.C. section 3105 (1982).

Petitioners suggest that because administrative agencies do not come within the term "Heads of Departments," Congress may not vest the authority to appoint inferior officers in agencies either. However, the Supreme Court has upheld the authority of administrative agencies to delegate their adjudicatory functions including their fact-finding role, to administrative law judges. *Morgan v. United States*, 298 U.S. 468, 481 (1936).

Until 1969, the Tax Court was an independent agency in the executive branch. See *Martin v. Commissioner*, 358 F.2d 63, 64 (7th Cir. 1966). While an independent executive agency, the Tax Court would have been able to appoint its own special trial judges. See *Morgan v. United States, supra* at 481.

In 1969, the Tax Court was established by Congress as an Article I court. Section 7441. Petitioners, in effect, contend that by elevating the Tax Court to an Article I court Congress rendered itself powerless to authorize the Court to appoint its own special trial judges or even its own clerk. See *Ex parte Hennen, supra*. We find this conclusion untenable.

Legislative Officer

Petitioners further contend that because the Tax Court's authority is derived from Article I, the chief judge of the Tax Court is a legislative officer and that legislative officers are not permitted to appoint inferior officers under the Appointments Clause. See *Buckley v. Valeo, supra* at 127. We do not agree.

While the Tax Court's powers as an Article I court are not derived from Article III, those powers are nonetheless judicial. *Anthony v. Commissioner*, 66 T.C. 367, 369 (1976). The powers exercised by an officer, not the source of those powers, determine whether an officer is a legislative, executive or judicial officer under the Appointments Clause. *Buckley v. Valeo, supra* at 140-141. The Supreme Court held in *Williams v. United States*, 289 U.S. 553, 566-567 (1933), that Article I courts exercise judicial power. The Court stated that:

> The validity of this view is borne out by the fact that the appellate jurisdiction [or the Supreme Court's jurisdiction] over judgments and decrees of the legislative courts has been upheld and freely exercised

> under the acts of Congress from a very early period, a practice which can be sustained, as already suggested, only upon the theory that the legislative courts possess and exercise judicial power — as distinguished from legislative, executive, or administrative power — although not conferred in virtue of the third article of the Constitution.
>
> * * * * *
>
> If the power exercised by legislative courts is not judicial power, what is it? Certainly it is not legislative, or executive, or administrative power, or any imaginable combination thereof.

Because the powers exercised by the Tax Court are judicial powers, not legislative powers, Tax Court judges are judicial officers, not legislative officers. As judicial officers of the United States, Tax Court judges must be appointed by the President by and with the advice and consent of the Senate in accordance with the Appointments Clause. Section 7433(b).

Accordingly, petitioners' contention that the chief judge of the Tax Court is a legislative officer and thus cannot appoint inferior officers such as special trial judges is erroneous.

Chief Judge's Authority

Petitioners next contend that because the term "Courts of Law" in the delegation clause is in the plural form, Congress is required to vest the authority to appoint special trial judges in more than one judge of the Tax Court. We do not agree.

The terms "Courts of Law" and "Heads of Departments" in the delegation clause refer to the courts and departments which Congress is authorized to create. The term "Courts of Law" in no way implies that Congress must vest the authority to

appoint special trial judges in more than one judge. Thus, we hold that Congress has properly vested the authority to appoint special trial judges in the chief judge of the Tax Court.

Accordingly, petitioners' motions to vacate will be denied.

* * * * *

Petitioners have requested that if their motions are denied the Court, pursuant to Rule 193 and section 7482(a)(2), include a statement in its Order that there is controlling question of law involved as to which there is a substantial ground for a difference of opinion and that an immediate appeal from the Order may materially advance the ultimate termination of the litigation. The Court's interlocutory Order, a copy of which is attached hereto as Appendix E, contains such a statement.

We point out that, while such a statement has been included to comply with the statutory requirement, the views of this Court are unanimous. Resolution of this issue, however, is of critical importance not only for this case but also for the functioning of the Court generally. Accordingly, we have taken the unusual step of certifying this issue for interlocutory appeal in order to obtain expeditious resolution of whatever difference of opinion there might be.

An appropriate order will be entered.

Reviewed by the Court.

CHABOT, PARKER, KORNER, SHIELDS, HAMBLEN, COHEN, CLAPP, SWIFT, JACOBS, WRIGHT, PARR, WELLS, WHALEN, and COLVIN, JJ., agree with this opinion.

GERBER and RUWE, JJ., did not participate in the consideration of this opinion.

TAX COURT APPENDIX A

Authority to use special trial assistants originated in section 1114 of the Internal Revenue Code of 1939, as amended by section 503 of the Revenue Act of 1943, Pub. L. 78-235, 58 Stat. 21, 72, when the Board of Tax Appeals existed only as an executive agency. At that time, Congress permitted the presiding judge "from time to time by written order [to] designate an attorney from the legal staff of the court to act as a commissioner in a particular case. * * * [to] proceed under such rules and regulations as may be promulgated by the [Tax] court." H. Rept. No. 871, 78th Cong., 1st Sess. (1943), 1944 C.B. 901, 954.

That provision was continued without substantial change as section 7456(c) of the 1954 Code. In 1969, when the status of the Tax Court was changed from that of an independent agency of the Executive Branch to that of an Article I court, this provision was amended to delete the reference to attorneys from the Tax Court's legal staff and to provide for appointment of full-time commissioners for indefinite terms. Section 7456(c) was amended by section 958 of the Tax Reform Act of 1969, Pub. L. 91-172, 83 Stat. 487, 734, 1969-3 C.B. 161. In addition, section 957 of the same Act provided for the creation of a streamlined procedure for disputes involving $1,000 or less at the option of the taxpayer (and concurred in by the Tax Court), an amount increased to $1,500 in 1972. (Pub. L. 92-512, section 203(b)(2), 86 Stat., 1972-2 C.B. 700).

In 1978, Congress increased the jurisdictional amount to $5,000, again amending section 7456(c) to allow the Tax Court to authorize commissioners to enter decisions in declaratory judgment proceedings, and added section 7463(g), providing the same authority in the case of small tax proceedings. Revenue Act of 1978, Pub. L. 95-600, sections 336(b)(1), 502(a)(1) and (b), 92 Stat. 2841, 2879, 1978-3 C.B. (Volume 1) 75-76,

113. The provisions allowing entry of decisions by commissioners were eventually consolidated in section 7456(d) and expanded in 1982 to encompass all three categories of cases now set forth in section 7443A(b)(1)-(3). Section 7456(d) of the Code was amended by section 106(c)(1) of the Miscellaneous Revenue Act of 1982, Pub. L. 97-362, 96 Stat. 1726, 1730.

The provisions took essentially their present form in 1984 when the term "commissioner" was formally changed to "special trial judge" and a provision corresponding to present section 7443A(b)(4) was added by sections 463(a) and 464(b) of the Tax Reform Act of 1984, Pub. L. 98-369, 98 Stat. 494, 824. In 1986, the provisions of former section 7456(c) and (d) were moved to new section 7443A by section 1556(a) of Pub. L. 99-514, 100 Stat. 2085, 2754-2755.

TAX COURT APPENDIX B

RULE 183. CASES INVOLVING MORE THAN $10,000

Except in cases subject to the provisions of Rule 182 [cases involving $10,000 or more] or as otherwise provided, the following procedure shall be observed in cases tried before a Special Trial Judge:

(a) Trial and Briefs: A Special Trial Judge shall conduct the trial of any such case assigned to him for such purpose. After such trial, the parties shall submit their briefs in accordance with the provisions of Rule 151. Unless otherwise directed, no further briefs shall be filed.

(b) Special Trial Judge's Report: After all the briefs have been filed by all the parties or the time for doing so has expired, the Special Trial Judge shall submit his report, including his findings of fact and opinion, to the Chief Judge, and the Chief Judge will assign the case to a Division of the Court.

(c) Action on the Report: The Division to which the case is assigned may adopt the Special Trial Judge's report or may modify it or may reject it in whole or in part, or may direct the filing of additional briefs or may receive further evidence or may direct oral argument, or may recommit the report with instructions. Due regard shall be given to the circumstance that the Special Trial Judge had the opportunity to evaluate the credibility of witnesses, and the findings of fact recommended by the Special Trial Judge shall be presumed to be correct.

TAX COURT APPENDIX C

SEC. 7463. DISPUTES INVOLVING $10,000 OR LESS.

(a) IN GENERAL. — In the case of any petition filed with the Tax Court for a redetermination of a deficiency where neither the amount of the deficiency placed in dispute, nor the amount of any claimed overpayment, exceeds —

(1) $10,000 for any one taxable year, in the case of the taxes imposed by subtitle A,

(2) $10,000, in the case of the tax imposed by chapter 11,

(3) $10,000 for any one calendar year, in the case of the tax imposed by chapter 12, or

(4) $10,000 for any 1 taxable period (or, if there is no taxable period, taxable event) in the case of any tax imposed by subtitle D which is described in section 6212(a) (relating to a notice of deficiency),

at the option of the taxpayer concurred in by the Tax Court or a division thereof before the hearing of the case, proceedings in the case shall be conducted under this section. Notwithstanding the provisions of section 7453, such proceedings shall be conducted in accordance with such rules of evidence, practice, and procedure as the Tax Court may prescribe. A decision, together with a brief summary of the reasons therefor, in any such case shall satisfy the requirements of sections 7459(b) and 7460.

(b) FINALITY OF DECISIONS. — A decision entered in any case in which the proceedings are conducted under this section shall not be reviewed in any other court and shall not be treated as a precedent for any other case.

(c) LIMITATION OF JURISDICTION. — In any case in which the proceedings are conducted under this section, notwithstanding the provisions of sections 6214(a) and 6512(b), no decision shall be entered redetermining the amount of a deficiency, or determining an overpayment, except with respect to amounts placed in dispute within the limits described in subsection (a) and with respect to amounts conceded by the parties.

(d) DISCONTINUANCE OF PROCEEDINGS. — At any time before a decision entered in a case in which the proceedings are conducted under this section becomes final, the taxpayer or the Secretary may request that further proceedings under this section in such case be discontinued. The Tax Court, or the division thereof hearing such case, may, if it finds that (1) there are reasonable grounds for believing that the amount of the deficiency placed in dispute, or the amount of an overpayment, exceeds the applicable jurisdictional amount described in subsection (a), and (2) the amount of such excess is large enough to justify granting such request, discontinue further proceedings in such case under this section. Upon any such discontinuance, proceedings in such case shall be conducted in the same manner as cases to which the provisions of sections 6214(a) and 6512(b) apply.

(e) AMOUNT OF DEFICIENCY IN DISPUTE. — For purposes of this section, the amount of any deficiency placed in disputed includes additions to the tax, additional amounts, and penalties imposed by chapter 68, to the extent that the procedures described in subchapter B of chapter 63 apply.

(f) QUALIFIED STATE INDIVIDUAL INCOME TAXES. — For purposes of this section, a deficiency placed in dispute or claimed overpayment with regard to a qualified State individual income tax to which subchapter E of chapter 64 applies, for a taxable year, shall be treated as a portion of a deficiency placed in dispute or claimed overpayment of the income tax for that taxable year.

TAX COURT APPENDIX D

M. Farrand, 2 Records of the Federal Convention of 1787, pp. 627-628 (1966)

> Art II. sect. 2. (paragraph 2) To the end of this, Mr Governr. Morris moved to annex "but the Congress may by law vest the appointment of such inferior Officers as they think proper, in the President alone, in the Courts of law, or in the Heads of Departments." Mr. Sherman 2ded. the motion
>
> Mr. Madison. It does not go far enough if it be necessary at all — Superior Officers below Heads of Departments ought in some cases to have the appointment of the lesser offices.
>
> Mr Govr Morris. There is no necessity. Blank Commissioners can be sent —
>
> On the motion

> N.H. ay. Mas — no — Ct ay. N.J. ay. Pa. ay. Del. no. Md. divd. Va no. N.C. ay — S C no. Geo — no — [Ayes — 5; noes — 5; divided — 1.]
>
> The motion being lost by the equal division (of votes,) It was urged that it be put a second time, some such provision being too necessary, to be omitted, and on a second question it was agreed to nem. con.

TAX COURT APPENDIX E

UNITED STATES TAX COURT
Washington, D.C. 20217

FIRST WESTERN GOVERNMENT	Docket Nos. 25760-84
SECURITIES INC., ET AL.,	32276-84
PETITIONERS,	33758-84
v.	22524-85
	6400-86
COMMISSIONER OF	21748-86
INTERNAL REVENUE,	25978-86
Respondent.	2786-87

ORDER

On October 12, 1989, petitioners filed motions to vacate the assignment of special trial judge. On January 16, 1990, respondent filed objections to petitioners' motions for the assignment of these cases to a Presidentially appointed Judge of the United States Tax Court and memorandums of points and authorities in support of his objections. On February 15, 1990,

petitioners filed replies to respondent's objections to petitioners' motions to vacate the assignment of special trial judge.

After due consideration of petitioners' above-referenced motions to vacate the assignment of special trial judge, pursuant to I.R.C. section 7482(a)(2) and Rule 193, Tax Court Rules of Practice and Procedure, it is

ORDERED that petitioners' above-referenced motions to vacate the assignment of special trial judge are denied. It is further

ORDERED that these cases are hereby certified for interlocutory appeal to the United States Court of Appeals for the Second Circuit and the United States Court of Appeals for the Ninth Circuit, in that a controlling question of law is involved with respect to which there is a substantial ground for difference of opinion and that an immediate appeal from this order may materially advance the ultimate termination of the litigation in the above-docketed cases. It is further

ORDERED that all proceedings herein are stayed pending resolution of any interlocutory appeal.

/s/ ______________________

Arthur L. Nims, III
Chief Judge

Entered: April 9, 1990

APPENDIX D.

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Nos. 89-4436, 89-4439, 89-4440 and 89-4450

Thomas L. FREYTAG and Sharon N. Freytag, Petitioners-Appellants,
v.
COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellee.

Joe D. WOMBLE and Gladys E. Womble, Petitioners-Appellants,
v.
COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellee.

Bert C. TIMM and Mildred H. Timm, Petitioners-Appellants,
v.
COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellee.

Kenneth G. McCOIN and Candace G. McCoin, Petitioners-Appellants,
v.
COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellee.

Nos. 89-4436, 89-4439, 89-4440 and 89-4450.

Appeal from the Decision of the United States Tax Court

ON PETITION FOR REHEARING
(August 15, 1990)

Before GEE, POLITZ and JONES, Circuit Judges.

PER CURIAM:

IT IS ORDERED that the petition for rehearing filed in the above entitled and numbered cause be and the same is hereby denied.

ENTERED FOR THE COURT:

/s/ ______________________
Henry A. Politz
United States Circuit Judge

APPENDIX E.

Article I, § 8 of the Constitution of the United States provides:

> The Congress shall have Power . . . To constitute Tribunals inferior to the supreme Court . . . .

Article II, § 2 provides:

> The President . . . shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.

Article III, § 1 provides:

> The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish. The Judges, both of the supreme and inferior Courts, shall hold their Offices during good Behaviour . . . .

Article III, § 2 provides:

> The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority . . . .

APPENDIX F.

26 U.S.C. § 7443A. Special trial judges

(a) Appointment. — The chief judge may, from time to time, appoint special trial judges who shall proceed under such rules and regulations as may be promulgated by the Tax Court.

(b) Proceedings which may be assigned to special trial judges. — The chief judge may assign —

(1) any declaratory judgment proceeding,

(2) any proceeding under section 7463,

(3) any proceeding where neither the amount of the deficiency placed in dispute (withing the meaning of section 7463) nor the amount of any claimed overpayment exceeds $10,000, and

(4) any other proceeding which the chief judge may designate,

to be heard by the special trial judges of the court.

(c) Authority to make court decision. — The court may authorize a special trial judge to make the decision of the court with respect to any proceeding described in paragraph (1), (2), or (3) of subsection (b), subject to such conditions and review as the court may provide.

(d) Salary. — Each special trial judge shall receive salary —

(1) at a rate equal to 90 percent of the rate for judges of the Tax Court, and

(2) in the same installments as such judges.

(e) Expenses for travel and subsistence. — Subsection (d) of section 7443 shall apply to special trial judges subject to such rules and regulations as may be promulgated by the Tax Court.

(Added Pub.L. 99-514, Title XV, § 1556(a), Oct. 22, 1986, 100 Stat. 2754.)

APPENDIX G.

U.S. Department of Justice

Tax Division

Office of the Assistant Attorney General   Washington, D.C. 20530

April 25, 1990

Airborne Express

Gilbert F. Ganucheau, Esquire
Clerk, U.S. Court of Appeals
for the Fifth Circuit
Room 102, U.S. Court of Appeals
Courthouse
600 Camp Street
New Orleans, Louisiana 70130

Re: Thomas L. Freytag, et al. v. Commissioner (5th Cir. — No. 89-4436) Joe D. Womble, et al. v. Commissioner (5th Cir. — No. 89-4439) Bert C. Timm, et al. v. Commissioner (5th Cir. — No. 89-4440) Kenneth G. McCoin, et al. v. Commissioner (5th Cir. — No. 89-4450)

Dear Mr. Ganucheau:

The above-entitled consolidated cases are scheduled for oral argument on April 30, 1990. One of the issues in the cases concerns the constitutionality of the appointments of Special Trial Judges of the United States Tax Court under the Appointment Clause of the Constitution.

Pursuant to Fed. R. App. P. 28(j), we would like to call to the Court's attention the Statement of the President on Signing the Omnibus Budget Reconciliation Act of 1989, 25 Weekly

Comp. of Pres. Docs. 1970-1 (Dec. 19, 1989) (copy enclosed). This Statement came to the attention of the Tax Division after the filing of its brief in this case.

The arguments presented at pages 46-52 of our brief may be in tension with this Statement. Those arguments are currently being reviewed within the Department of Justice to determine whether they reflect its views.

Four copies of the Presidential Statement are enclosed for the Court's convenience. We are also forwarding a copy of this letter, together with a copy of the Statement, to counsel for the appellants.

Sincerely

/s/ ______________________________

Shirley D. Peterson
Assistant Attorney General
Tax Division

Statement on Signing the Omnibus Budget Reconciliation Act of 1989

* * * * *

I must note, however, that several provisions of this reconciliation bill raise constitutional concerns.

* * * * *

Provisions of the bill appending the National Vaccine Injury Compensation Program also raise concerns. These provisions would provide for initial adjudications of vaccine injury claims by a group of special masters appointed and removable by the United States Claims Court. Although I understand and strongly sympathize with the desire of the Congress to ensure speedy and equitable settlement of meritorious claims, such dispute resolution must take place within the structure of responsible Government established by our Constitution.

The bill's imposition of an "arbitrary and capricious" standard for review of special master decisions by Claims Court judges could raise constitutional questions by vesting significant authority pursuant to the laws of the United States in persons whose appointment and removal are inconsistent with the requirements of Article II of the Constitution, and by circumscribing the ability of Article I and Article III judges to review the decisions of these persons. Accordingly, to place this issue beyond doubt, the Attorney General and the Secretary of HHS will work together to submit legislation that would ensure *de novo* review of decisions rendered by the special masters.

George Bush

The White House,
December 19, 1989.

Note: H.R. 3299, approved December 19, was assigned Public Law No. 101-239.

APPENDIX H.

United States Department of Justice.

Tax Division

John M. Greacen, Esquire
Clerk, U. S. Court of Appeals
for the Fourth Circuit
Room 402, U. S. Courthouse
10th and Main Streets
Richmond, Virginia 23219

August 28, 1990

Re: Littleton G. Lewis, Jr. and Irene Lewis v. Commissioner (4th Cir. – No. 89-2720)

Dear Mr. Greacen:

As you know, the above-entitled case is currently being held in abeyance pending final action on a settlement reached by the parties herein. Before the appeal was held in abeyance, the Government had filed a response to a motion filed by appellant concerning the constitutionality of the appointments of the special trial judges of the Tax Court. Although the Government adheres to the position set forth therein that the appointments of special trial judges comport with the requirements of the Constitution, it had, upon further consideration, concluded that, contrary to the position set forth in that response, the Tax Court is not a "Court[ ] of Law" within the meaning of the Appointments Clause, but that the chief judge of the Tax Court may nevertheless appoint subordinate officers of that court as the "Head[ ] of [a] Department[ ]" under that Clause. This position has now been set forth in the Government's brief filed on August 27, 1990, in a related case presenting this same issue, *Samuels Kramer & Co. v. Commissioner*,

(2d Cir. – Nos. 90-4060, 90-4064). Since the parties here have reached a settlement of the appeal, and are currently awaiting recomputations in accordance with the settlement, there appears to be no reason for the Government to file a supplemental response at this time. We do, however, with to note for the record that the Government's response of January 4, 1990, is not fully in accord with the view of the Government on the question presented. If, for any reason, further proceedings would become necessary herein, we would, of course, request permission to file a supplemental response in accord with the position taken on brief in the *Samuels Kramer & Co.* case.

This case is currently assigned to Steven W. Parks, who may be reached at (202) 514-2958 or FTS 368-2958.

Sincerely yours,

SHIRLEY D. PETERSON
Assistant Attorney General
Tax Division

By:

GARY R. ALLEN
Chief, Appellate Section
Tax Division
Department of Justice
Post Office Box 502
Washington, D.C. 20044
(202) 514-3361
(FTS) 368-3361

Supreme Court, U.S.
FILED
DEC 19 1990
JOSEPH F. SPANIOL, JR.
CLERK

(2)

No. 90-762

In the Supreme Court of the United States

OCTOBER TERM, 1990

THOMAS FREYTAG, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

KENNETH W. STARR
Solicitor General

SHIRLEY D. PETERSON
Assistant Attorney General

GARY R. ALLEN
STEVEN W. PARKS
Attorneys

Department of Justice
Washington, D.C. 20530
(202) 514-2217

QUESTIONS PRESENTED

1. Whether a special trial judge of the Tax Court could hear petitioners' cases and prepare a report on them under Section 7443A(b)(4) of the Internal Revenue Code (26 U.S.C.).

2. Whether petitioners could consent to have their cases heard by a special trial judge whose appointment they now assert to be in violation of the Appointments Clause, Art. II, § 2, Cl. 2.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

In the Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-762

THOMAS FREYTAG, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals, Pet. App. A1-A13, is reported at 904 F.2d 1011. The opinion of the United States Tax Court, Pet. App. A14-A69, is reported at 89 T.C. 849.

JURISDICTION

The judgment of the court of appeals was entered on July 6, 1990. A petition for rehearing was denied on August 15, 1990. Pet. App. A97-A98. The petition for a writ of certiorari was filed on November 13, 1990. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISION INVOLVED

Section 7443A of the Internal Revenue Code (26 U.S.C.) provides in pertinent part as follows:

(b) **Proceedings which may be assigned to special trial judges**

The Chief judge may assign—

(1) any declaratory judgment proceeding,
(2) any proceeding under section 7463,
(3) any proceeding where neither the amount of the deficiency placed in dispute (within the meaning of section 7463) nor the amount of any claimed overpayment exceeds $10,000, and
(4) any other proceeding which the chief judge may designate,

to be heard by the special trial judges of the court.

(c) **Authority to make court decision**

The court may authorize a special trial judge to make the decision of the court with respect to any proceeding described in paragraph (1), (2), or (3) of subsection (b), subject to such conditions and review as the court may provide.

STATEMENT

Petitioners attempted to deduct on their income tax returns large "losses" supposedly incurred as a result of their participation in a tax shelter scheme. When the Commissioner of Internal Revenue disallowed those deductions, petitioners filed petitions in the Tax Court. Trial began before a regular judge of the Tax Court,[1] but that judge became ill shortly after trial began. A special trial judge[2] was assigned

[1] The Tax Court is comprised of 19 judges who are nominated by the President and confirmed by the Senate to serve fixed terms of 15 years. 26 U.S.C. 7443(a), (b) and (e).

[2] A special trial judge is appointed by the chief judge of the Tax Court. 26 U.S.C. 7443A(a). The Tax Court currently

to complete the trial, which was videotaped so that the regular judge could view the testimony and ultimately render the decisions.

After all the evidence was taken, however, the regular judge became too ill to decide the cases, and he retired as an active judge. Petitioners then consented to having the special trial judge prepare findings and a proposed opinion to enable another regular judge of the Tax Court to decide their cases. The special trial judge's report found that the tax shelter in which petitioners participated was a sham and that petitioners entered into the shelter primarily to avoid payment of income taxes. Pet. App. A47. The chief judge of the Tax Court adopted the special trial judge's report and entered decisions in favor of the Government. Pet. App. A14. The court of appeals affirmed. Pet. App. A1-A13.

1. Each of the petitioners invested in a commodity tax straddle program operated by First Western Government Securities (First Western). Stated simply, petitioners informed First Western how much tax loss they wished to secure and First Western charged petitioners fees of seven to eight percent of the desired losses. The fees supposedly were paid for contracts to take or deliver Government mortgage-backed securities approximately 14 to 30 months in the future. In fact, no market in these securities existed so far in the future and no securities were ever delivered. Instead, First Western created investment portfolios on a computer in which petitioners would simultaneously contract to buy securities at some future date (the "long" leg of the

employs 14 special trial judges. Special trial judges receive 90% of the salary of regular Tax Court judges and do not serve fixed terms. 26 U.S.C. 7443A(d).

straddle) and sell similar securities at another future date (the "short" leg of the straddle). If allowed by the Internal Revenue Code, the straddle scheme would have allowed petitioners to close out the loss leg and deduct the loss against that year's ordinary income, while at the same time holding open the gain leg until a later year and deferring recognition of income. Pet. App. A3-A5, A8-A9, A14-A15, A19 n.6, A25-A26.

2. The Commissioner disallowed deductions generated by "investments" in First Western, and participants in that scheme filed approximately 3,000 cases in the Tax Court asserting the deductibility of their "losses." Petitioners' four cases, together with six others, were chosen as test cases and consolidated for trial.[3] Pet. App. A5.

Trial commenced in December of 1984 before the Honorable Richard C. Wilbur, a regular judge of the Tax Court. When Judge Wilbur became ill, Chief Judge Samuel B. Sterrett assigned the cases to Special Trial Judge Carleton D. Powell to complete the trial. The proceedings were videotaped so that Judge Wilbur could view the testimony at home and prepare a report and render the decisions when he recovered his health. None of the petitioners objected to this assignment. Pet. App. A5-A6.

After all the evidence was taken, Judge Wilbur learned that his medical condition would not allow him to prepare the report and decide petitioners' cases.[4] By order dated July 23, 1986, Chief Judge

[3] Appeals from the decisions entered in three of the other test cases were taken to the United States Courts of Appeals for the Fourth and Sixth Circuits. Those cases were later settled.

[4] Judge Wilbur's disability compelled him to retire from the Tax Court, and he has assumed senior status.

Sterrett notified the parties that—unless they objected—he would assign Special Trial Judge Powell to prepare the report in their cases in accordance with Section 7443A(b)(4) of the Internal Revenue Code (26 U.S.C.), and that action on the report would be taken "by Judge Wilbur, or if not by this Division of the Court." App., *infra*, 2a. One taxpayer objected to the assignment, and its case was severed. The remaining taxpayers, including petitioners, agreed to the assignment on the understanding that Judge Wilbur or Chief Judge Sterrett would review Special Trial Judge Powell's report and make the decision of the Tax Court in accordance with Section 7443A(c) of the Code (26 U.S.C.). Pet. App. A6; App., *infra*, 1a-2a.

Special Trial Judge Powell's report recommended that petitioners' deductions not be allowed. He found that "[t]he transactions between First Western and its customers were illusory and fictitious" and were "entered into primarily, if not solely, for tax-avoidance purposes." Pet. App. A47. His report described a tax shelter scheme in which First Western's ability to "control[] losses" through its computer system was so "fine[ly]-tune[d]" that it could "reach any result" its clients desired. *Id.* at A50. The computer-created "market" in which petitioners "invested" was so artificial that it "could not have existed if there had been any real economic substance to its program." *Id.* at A54. In reality, "First Western's world consisted of a computer spitting out paper showing huge transactions that had no economic significance except in petitioners' attempts to raid Federal and State fiscs." *Ibid.* The report concluded that petitioners should be sanctioned under Section 6673 of the Code (26 U.S.C.), because their litigating position was "frivolous." But rather than sanction petitioners and

their counsel, the report merely served notice that petitioners' cases would be "the last free bites of that apple." Pet. App. A64.

On October 21, 1987, Chief Judge Sterrett entered an order adopting the special trial judge's proposed findings and opinion and holding that petitioners' straddle transactions with First Western were shams and, in the alternative, were not entitled to loss deductions because they had not been entered into primarily for profit.[5] Decisions were subsequently entered in accordance with that opinion by Judge Sterrett's successor as chief judge of the Tax Court, the Honorable Arthur L. Nims, III. Pet. App. A6, A14, A47-A65.

3. Petitioners appealed on the grounds that the transactions they entered into with First Western were not shams, and that they had intended to make a profit. For the first time, petitioners also argued

[5] Petitioners assert that Chief Judge Sterrett adopted the special trial judge's report within a "few hours" after its submission. Pet. 3, 12. In fact, the record does not reveal the date on which the special trial judge submitted his report to the chief judge. Petitioners apparently *assume* that Chief Judge Sterrett did not review the special trial judge's report before he formally assigned petitioners' cases to himself that same day.

The date on which Chief Judge Sterrett formally assigned the cases to himself is no evidence of the date on which he received the special trial judge's report. The chief judge entered numerous orders in petitioners' cases prior to that date. The chief judge's statutory duty was to review petitioners' cases in sufficient detail so that the decision he entered was his own, and not the special trial judge's. 26 U.S.C. 7443A(c). There is no basis in the record for assuming he did not do so. Cf. *FCC* v. *Schreiber*, 381 U.S. 279, 296 (1965) (administrative agencies are entitled to the presumption "that they will act properly and according to law").

that the assignments of their cases to the special trial judge were unlawful. They contended that Section 7443A(b)(4) of the Code (26 U.S.C.) allows special trial judges to hear only minor tax cases. In addition, they contended that appointment of special trial judges by the chief judge of the Tax Court, as authorized by Section 7443A(a) of the Code, violates the Appointments Clause of the Constitution, Art. II, § 2, Cl. 2. Pet. App. A7-A9 & n.9, A11 n.11.

The court of appeals affirmed the Tax Court's decisions in all respects. It held that Section 7443A(b)(4) of the Code (26 U.S.C.) authorized assignment of petitioners' cases to a special trial judge for hearing and report, and observed that Tax Court procedure requires a regular judge of the Tax Court to "control[] the outcome of the case."[6] The court further concluded that by consenting to the assignment of their cases to the special trial judge, petitioners waived any objection they might have raised under the Appointments Clause. Pet. App. A7-A8 & nn.7, 9.

On the deductibility of petitioners' claimed tax shelter "losses," the court of appeals held that the

[6] The court of appeals rejected petitioners' assertion that Chief Judge Sterrett "rubber-stamped," Pet. 12, the special trial judge's report and instead presumed that he fulfilled his duty to review the report and enter his own decision for the Tax Court. The court of appeals observed that "[t]he record before us is devoid of any evidence that even remotely suggests otherwise, other than the short time span between the filing of the special tax judge's report and the issuance of the Tax Court's opinion by its chief judge." Pet. App. A8.

Although petitioners repeat their belief that Chief Judge Sterrett exercised only "cursory supervision" over the special trial judge, Pet. 11; see *id.* at 2, 13, they do not seek review of the court of appeals' rejection of their claim.

Tax Court "could not help but" conclude that the First Western transactions were shams, Pet. App. A8, and that it was "ludicrous to suggest that these petitioners had anything but a most fleeting interest in a potential economic gain" with respect to those transactions, *id.* at A11 n.11. Accordingly, the court affirmed the disallowance of petitioners' deductions.

ARGUMENT

The decisions of the courts below are correct and do not conflict with the decisions of any other courts. Further review is not warranted.

1. Section 7443A(b)(4) is clear on its face: "The chief judge may assign— * * * (4) any other proceeding which the chief judge may designate [*i.e.*, any proceeding other than the ones listed in subsections (1) through (3)], to be heard by the special trial judges of the court." The legislative history confirms that "any other proceeding" carries no hidden limitations regarding case size or complexity. In amending former Section 7456(d) (now Section 7443A) in 1984 to provide expressly for this category of assignments, the House Report explains:

> A technical change is made to allow the Chief Judge of the Tax Court to assign *any* proceeding to a special trial judge *for hearing and to write proposed opinions*, subject to review and final decision by a Tax Court judge, *regardless of the amount in issue*. However, special trial judges will not be authorized to enter decisions in this latter category of cases.

1 H.R. Rep. No. 432, 98th Cong., 1st Sess. 266 (1983) (emphases added). The Conference Report

"follows the House bill." H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. 1127 (1984).[7]

The "technical" nature of the 1984 amendment adding Section 7443A(b)(4) underscores the fact that the historic office of the special trial judge (and his predecessor, the commissioner) has been to hear and prepare reports on *any* cases within the Tax Court's jurisdiction. Prior statutes imposed no limitations whatsoever on the cases that a special trial judge could be assigned to hear (but not decide). *E.g.*, Revenue Act of 1943, ch. 63, § 503, 58 Stat. 72; Section 7456(c) of the Internal Revenue Code of 1954 (as originally enacted); Tax Reform Act of 1969, Pub. L. No. 91-172, § 958, 83 Stat. 734.[8]

---

[7] Petitioners cite but one case in support of their contention that only minor tax cases may be assigned to special trial judges under Section 7443A(b). Pet. 9. That case is *Page v. Commissioner*, 86 T.C. 1, 12-13 (1986). Critically, *Page* involved the small case procedure of Section 7443A(b)(2) and Section 7463 (*i.e.*, that applicable to cases involving less than $10,000), *not* the "any other proceeding" category established by Section 7443A(b)(4) and pursuant to which the special trial judge was assigned to hear petitioners' cases. Thus, the Tax Court's holding in *Page* that the small case procedure should not be employed when the issues presented are significant casts no doubt on the propriety of the assignment in petitioners' cases. Any doubt whether the Tax Court believes that major tax cases may be assigned to special trial judges under Section 7443A(b)(4) is completely dispelled by petitioners' own observation that "14,500 complex so-called tax shelter cases" are presently assigned to special trial judges of the Tax Court "pursuant to § 7443A(b)(4)." Pet. 2 n.2.

[8] By comparison, the authority to assign special trial judges to *enter decisions* in cases has been expressly limited to narrow categories of cases since its origin in 1974 as a mechanism to accommodate an anticipated flood of employee benefit cases. Employee Retirement Income Security Act of 1974,

Notwithstanding the unambiguous statutory text, committee report, and history of Section 7443A (b)(4), petitioners contend that the proceedings to which special trial judges may be assigned to hear and report under subsection (b)(4) should be limited to those "minor tax cases," Pet. 9-10, described in subsections (b)(1) through (b)(3), in which special trial judges may enter the decision of the Tax Court. Petitioners' contention is an ejusdem generis argument in disguise.[9] But it disregards the triggering principle of that canon of construction—namely, that the general phrase following the specific phrases must be of the same class. Section 7443A(c) indicates that the proceedings described in subsection (b)(4) are in a different class than the proceedings in subsections (b)(1) through (b)(3). The latter proceedings include declaratory judgment proceedings ((b)(1)), small cases (involving less than $10,000 conducted under the procedures set forth in Section 7463 of the Code ((b)(2)), and other small cases involving less than $10,000 ((b)(3)). In each of those three proceedings, the chief judge may authorize a special trial judge to render the decision of the Tax Court. Section 7443A(c). In contrast, in proceedings under subsection (b)(4)—"any other proceeding" except the three previously listed—the case may only be

Pub. L. No. 93-406, § 1041(a), 88 Stat. 949-950; see Sections 336(b)(1) and 502(b) of the Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2841-2842, 2879) (codified as amended at 26 U.S.C. 7443A(b)(1)-(3)).

[9] This canon provides that general words following specific words in a statutory enumeration are to be construed to embrace objects similar in nature to those covered by the specific words. See, *e.g.*, *Garcia* v. *United States*, 469 U.S. 70, 74 (1984).

"heard" by the special trial judge; a regular judge of the Tax Court must make the ultimate decision. Section 7443A(c); Tax Ct. R. 183. The inescapable inference from the statutory language and structure is that Congress intended to differentiate between declaratory judgment actions and small proceedings, which a special trial judge could hear *and* decide, and "any other proceeding," which the special trial judge could be assigned to hear, but *not* decide.[10]

Petitioners' reliance on *Gomez* v. *United States*, 109 S. Ct. 2237 (1989), Pet. 10-11, is entirely misplaced. That case involved the question whether the Federal Magistrates Act, 28 U.S.C. 636(b), authorized a District Court judge to assign a magistrate to preside over a selection of a jury in a felony trial without the defendant's consent. Although this Court observed that the statutory language broadly allowed assignment to a magistrate of "such additional duties as are not inconsistent with the Constitution and laws of the United States," it reasoned that presiding over jury selection was unrelated to the carefully defined grant of authority to conduct trial of civil matters and of minor criminal cases, and was at odds with the "repeated statements" in the legislative history that magistrates should only "handle subsidiary matters to enable district judges to concentrate on trying cases." 109 S. Ct. at 2245. As a result, the

[10] This difference between proceedings under subsections (b)(1)-(3) and those under subsection (b)(4) also answers petitioners' contention that a literal construction of "any other proceeding" in the latter subsection would render the former "superfluous." Pet. 9. The distinguishing feature of proceedings under subsections (b)(1)-(3)—that special trial judges can make the decision of the Tax Court—gives them independent significance regardless of the scope given to subsection (b)(4).

Court concluded that Congress did not intend for the "additional duties" clause to embrace presiding over jury selection in felony trials. *Id.* at 2247. Unlike the structure and legislative history of 28 U.S.C. 636, however, the structure and legislative history of Section 7443A(b) demonstrate that Congress unequivocally intended to authorize the chief judge of the Tax Court, in his discretion, to designate special trial judges to hear and prepare proposed findings and opinions in "any" proceeding before the Tax Court, regardless of the amount involved or the nature of the controversy. Accordingly, *Gomez* provides no basis for disregarding the plain language of the statute and the equally unambiguous legislative history.

At bottom, petitioners' abiding concern is that Chief Judge Sterrett "rubber-stamped the special trial judge's findings and opinion just a few hours after receiving them without reviewing the evidence or changing a single word." Pet. 12; see *id.* at 2. As we have pointed out, the basis for this accusation is a nonsequitur, note 5, *supra*; petitioners' charge was not credited by the court of appeals, note 6, *supra*; and petitioners do not seek this Court's review of their indictment, *ibid.*[11]

---

[11] Although one court of appeals has held that the Tax Court can review the proposed factual findings of a special trial judge only under a "clearly erroneous" standard of review, see *Stone* v. *Commissioner*, 865 F.2d 342, 345 (D.C. Cir. 1989), reversing *Rosenbaum* v. *Commissioner*, 45 T.C.M. (CCH) 825 (1983), the Tax Court itself has never retreated from its established practice, as set forth in that case, that it retains the ultimate responsibility for making all factual determinations, unfettered by the proposed findings that might be set forth in a special trial judge's report. Moreover, after *Stone* was decided the Tax Court abandoned its practice of furnishing litigants a copy of the special trial judge's report and inviting the parties to file exceptions. Pet. App. A8 n.8. As the court of appeals concluded, "this change in rules, in our view, confirms that the Tax Court's relationship with its special trial judges cannot be analogized to typical appellate review." *Ibid.* Instead, notwithstanding "that the special trial judge's recommended findings of fact shall be presumed correct, it is the division of the Tax Court to which the case is formally assigned that controls the outcome of the case." *Id.* at A7 n.8. The court of appeals' understanding was also petitioners' position, at least in the court of appeals. Pet. C.A. Reply Br. 3 ("Petitioners are entitled to a careful *de novo* review of the findings of a special trial judge by a tax court judge because the special trial judge cannot make the decision in a case assigned to him under § 7443A(b)(4)" (footnote and citation omitted)). But see Pet. 11 ("This presumption [of correctness due the factual findings of special trial judges] flatly precludes *de novo* review by the Tax Court.").

2. Because petitioners expressly consented to the assignment of the special trial judge who heard their cases in the Tax Court, the court of appeals did not address the merits of their constitutional challenge to his appointment under the Appointments Clause, Art. II, § 2, Cl. 2. Pet. App. A8 n.9 ("By consenting to the assignment * * * the Taxpayers waived this objection."). In the absence of any consideration of the merits of petitioners' Appointments Clause challenge by *any* court of appeals, it would be premature for this Court to resolve that issue in the first instance.[12] The only question properly before the Court

---

[12] At this time, only the Tax Court has addressed the Appointments Clause issue petitioners urge the Court to decide. In a decision involving First Western itself and its principal promoters, which was rendered after the decisions in petitioners' cases, the Tax Court sustained the appointments of the special trial judges. *Samuels, Kramer & Co.* v. *Commissioner*, 94 T.C. 549 (1990), appeal pending, Nos. 90-4060 & 90-4064 (2d Cir.). Unlike petitioners, the taxpayers involved

is whether petitioners could effectively consent to have their cases heard by a special trial judge whose appointment might otherwise have been challenged under the Appointments Clause.

In determining whether this consent question merits the Court's review, the Court should reject at the outset petitioners' fact-bound contention that their consent was "[]coerced" because the alternative was to retry their case before a new judge. Pet. 27-28. This plea might have merit in other cases. But cf. *CFTC* v. *Schor*, 478 U.S. 833, 850 (1986) (not finding coercive consent to trial before an administrative adjudicator even though "quicker and less expensive" than trial in court). But it has a singularly insincere ring in a case, such as this one, where the relief petitioners seek is precisely the retrial they claim "[]coerced" their consent to begin with. In sum, the Court should grant review of the consent question only if it believes that (1) litigants cannot under any circumstances consent to the assignment of a special trial judge to hear their cases, and (2) this issue is worthy of review even in the absence of a conflict in the circuits. The consent question does not warrant review.

a. This Court has emphasized that "[n]o procedural principle is more familiar to [the] Court than that a * * * right may be forfeited in criminal as well as civil cases by failure to make timely assertion of the right before a tribunal having jurisdiction to determine it." *Yakus* v. *United States*, 321 U.S. 414, 444 (1944); accord *United States* v. *Socony-Vacuum Oil Co.*, 310 U.S. 150, 238-239 (1940); *Blair* v. *Oesterlein Co.*, 275 U.S. 220, 225 (1927) ("There are specially cogent reasons why this rule should be

---

in *Samuels*, *Kramer* objected to the assignment of their cases to a special trial judge.

adhered to when the question involves a practice of one of the great departments of the government."); see *United States* v. *Gagnon*, 470 U.S. 522, 528 (1985) (per curiam) (holding right to be present at all stages of a criminal trial waived); *Levine* v. *United States*, 362 U.S. 610, 619 (1960) (holding due process right to public trial waived); *Segurola* v. *United States*, 275 U.S. 106, 111-112 (1927) (holding Fourth Amendment challenge waived). Requiring timely assertion of an objection serves two important purposes: it promotes judicial economy by alerting the lower court to a problem at a time when it can take corrective action, see *Wainwright* v. *Sykes*, 433 U.S. 72, 90 (1977); and it prevents a party from pursuing a certain course at trial for tactical reasons and later—if the outcome is unfavorable—claiming that the course followed constituted reversible error, see *id.* at 89.

Petitioners' conduct in this case falls squarely within the letter and spirit of this Court's settled practice of requiring contemporaneous objections. Petitioners did more than just commit a procedural default in the Tax Court, they expressly consented to the assignment of a special trial judge to hear their cases. Petitioners' consent led the Tax Court to assign special trial judge Powell to prepare a report on their cases, rather than another judge, as was ordered in the case of the one litigant who *did* object to the assignment. See p. 5, *supra*. If petitioners are permitted to withdraw their consent now, many months of trial time will have been wasted. What is worse, petitioners will have been permitted to withdraw their consent and assert reversible error not just after the trial, but after they learned that the supposed error did not work to their benefit. The sequence of events in this litigation illustrates precisely

what the contemporaneous objection rule was designed to prevent.

b. In the court of appeals, petitioners attempted to avoid the contemporaneous objection requirement by invoking the exception which prevents parties from conferring subject matter jurisdiction on a court by their consent. See *Bender* v. *Williamsport Area School Dist.*, 475 U.S. 534, 541 (1986). That exception has no application here.

A subject matter jurisdiction challenge questions the authority of the *office*, not the authority of the particular occupant of the office (the *officer*). The court of appeals understood this distinction. It allowed petitioners to challenge for the first time on appeal a purported statutory limitation on the subject matter jurisdiction of the special trial judge to hear and report on their cases under Section 7443A (b)(4) of the Code (26 U.S.C.). Pet. App. A7. At the same time, it declined to entertain petitioners' attack on the method by which the special trial judge assigned to hear their cases was appointed. See *id.* at A8 n.9. Unlike challenges to subject matter jurisdiction, an Appointments Clause argument

> is not "jurisdictional" in the sense that it cannot be waived by failure to raise it at the proper time and place. It is not the sort of claim which would defeat jurisdiction in the District Court by showing that an Article III "Case" or "Controversy" is lacking.

Morrison v. *Olson*, 487 U.S. 654, 670 (1988). If the Appointments Clause challenge in *Morrison* could not be waived, this Court would have had no occasion to consider (as it did in the indented quotation above) whether the rule of *Blair* v. *United States*, 250 U.S. 273, 282-283 (1919), barred a challenge to the independent counsel's appointment. For if the manner

of appointment can be questioned at any stage of the litigation, no rule governing the scope of appeals such as the one in *Blair* could have insulated the allegedly defective appointment from this Court's review. In that event, this Court would simply have made that point and promptly disposed of *Blair*. It did not. The necessary implication of the Court's analysis is that Appointments Clause challenges directed solely at the officer are not the same as jurisdictional challenges directed at the office; the former, unlike the latter, can be waived.[13]

c. For the first time in this Court, petitioners now claim that an argument premised on the Constitution's structural separation of powers is not available. Pet. 24-26.

In *CFTC* v. *Schor*, *supra*, this Court held that parties may waive their personal right to adjudication by an Article III court, 478 U.S. at 848-850, but "[t]o the extent that this structural principle [of Article III] is implicated in a given case, * * * notions of consent and waiver cannot be dispositive because the

[13] *Glidden Co.* v. *Zdanok*, 370 U.S. 530 (1962), and *Lamar* v. *United States*, 241 U.S. 103 (1916), on which petitioners rely, Pet. 26, are not to the contrary. Neither case holds that this Court *must* depart from its settled practice of requiring a contemporaneous objection. At most, those cases stand for the proposition that the Court has subject matter jurisdiction to reach the merits of a constitutional claim not raised by the parties below. *Glidden Co.* v. *Zdanok*, 370 U.S. at 535-537 (plurality opinion); *Lamar* v. *United States*, 241 U.S. at 117-118; cf. *McGoldrick* v. *Compagnie Generale Transatlantique*, 309 U.S. 430, 434-435 (1940) ("But it is also the settled practice of this Court, in the exercise of its appellate jurisdiction, that it is only in exceptional cases, and then only in cases coming from the federal courts, that it considers questions urged by a petitioner or appellant not pressed or passed upon in the courts below.").

limitations serve institutional interests that the parties cannot be expected to protect," *id.* at 850-851. In *Schor*, the institutional interest at stake was the "institutional integrity of the Judicial Branch," *id.* at 851—an interest that was arguably threatened by the adjudication of a " 'private' right" claim in a non-Article III court, *id.* at 853.

Unlike the situation in *Schor*, the assignment of special trial judges in Tax Court cannot raise the specter of "a phalanx of non-Article III tribunals equipped to handle the entire business of the Article III courts," 478 U.S. at 855, because tax controversies are not matters of private right "normally reserved to Article III courts," *id.* at 853. As petitioners concede, Pet. 16-17, tax disputes are "matters, involving public rights, * * * which congress may or may not bring within the cognizance of the courts of the United States, as it may deem proper," *Murray's Lessee* v. *Hoboken Land & Improvement Co.*, 59 U.S. (18 How.) 272, 284 (1855). The need to enforce "Article III limitations" that prompted the Court to dishonor the express consent in *Schor* thus has no application to this case.[14]

Nor does the rationale of *Schor* justify creation of an exception to the contemporaneous objection requirement for the Appointments Clause challenge raised by petitioners in this case. Together with the Incompatibility Clause, Art. I, § 6, Cl. 2, the Ap-

[14] *Pacemaker Diagnostic Clinic of America* v. *Instromedix*, 725 F.2d 537 (9th Cir) (en banc), cert. denied, 469 U.S. 824 (1984), is distinguishable for the same reason. At issue in that case was the consensual assignment of a case to a magistrate for adjudication. Thus, the case presented essentially the same question as in *Schor*—whether an official who did not enjoy the life tenure and salary protection guaranteed to the Article III judiciary could properly adjudicate the claims in question.

pointments Clause reflects the Framers' rejection of the cardinal feature of Parliamentary systems in which members of the Legislature serve as and appoint executive officers. The structural interests protected by the Appointments Clause are thus those of the President and the Executive Branch itself, which can be expected vigorously to challenge legislative encroachments on the presidential prerogatives under that Clause. Unlike the Article III limitations at issue in *Schor*—which could not be waived "because the limitations [of Article III] serve institutional interests that the parties cannot be expected to protect," 478 U.S. at 851—the Appointments Clause embodies an interest that at least one of the parties to every tax dispute (the United States) can be expected to protect. Accordingly, there is no reason, as there was in *Schor*, for saving petitioners from the choice they made when they affirmatively consented to allow the trial to proceed in accordance with statutory procedures.

* * * * *

In light of petitioners' express consent to the hearing before a special trial judge, the petition should not be held pending the Second Circuit's decision in *Samuels, Kramer & Co.* v. *Commissioner*, Nos. 90-4060 & 90-4064, Pet. 8—a case in which the taxpayers did not expressly consent to hearing before a special trial judge.[15] This petition cannot in any sense be "held" for *Samuels, Kramer* because the Second Circuit has not handed down any judgment, its decision will not necessarily decide the Appoint-

[15] In *Samuels, Kramer*, the Government is defending the authority of the chief judge of the Tax Court to appoint such special trial judges on the theory that he qualifies as the "Head[] of [a] Department[]" within the scope of that Clause.

ments Clause issue on which petitioners seek review (the government presented two alternative grounds for decision), the losing party (whichever side that may be) has not decided to file a petition for a writ of certiorari, and this Court has not determined whether the issue merits review at this time.

In truth, petitioners move this Court to defer consideration of their petition for an indeterminate time until it becomes known whether a petition for a writ of certiorari raising the Appointments Clause question will be filed in *Samuels, Kramer*. Regardless of the outcome in *Samuels, Kramer*, however, petitioners are not entitled to benefit from any decision this Court might render in that case because they expressly consented to the procedure to which the taxpayer in *Samuels, Kramer* timely objected. See *Yakus* v. *United States*, 321 U.S. at 444. Further delay is inappropriate in these cases. Five judges have now found petitioners' contentions on the deductibility of their tax shelter losses "frivolous" or "ludicrous." See pp. 5, 8, *supra*.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

KENNETH W. STARR
Solicitor General

SHIRLEY D. PETERSON
Assistant Attorney General

GARY R. ALLEN
STEVEN W. PARKS
Attorneys

DECEMBER 1990

APPENDIX

UNITED STATES TAX COURT
Washington, D.C. 20217

First Western Government Securities, Inc. Cases

Docket Nos. 4934-82, 9307-82, 27146-82, 29012-82, 1240-83, 3250-83, 8616-83, 14965-83, 33016-83, 204-84, 3749-84, 7658-84, 11821-84

THOMAS L. FREYTAG AND
SHARON N. FREYTAG, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

NOTICE OF PROPOSED REASSIGNMENT

Judge Richard C. Wilbur, to whom the above-captioned cases were assigned and before whom these same cases were partially tried, retired as an active judge on the Court due to physical disability and immediately assumed senior status, effective April 1, 1986. By direction of the Chief Judge, Special Trial Judge Carleton D. Powell completed the trial of these cases. This will serve as notice to the parties that these cases will be reassigned to Special Trial Judge Carleton D. Powell for purposes of preparing the report pursuant to Rule 183 of this Court's Rules. It is further contemplated that all other cases involving the same issue, which are presently assigned

to Judge Wilbur, will be reassigned to Special Trial Judge Powell.

If any motions are contemplated with respect to this reassignment, they should be filed on or before August 25, 1986. If no motions are received by the Court by that date these cases will be reassigned to Special Trial Judge Powell and pursuant to Rule 183(c) of the Court Rules, action on this report will be taken by Judge Wilbur, or if not by this Division of the Court.

/s/ Samuel B. Sterrett
SAMUEL B. STERRETT
Chief Judge

Dated: Washington, D.C.
July 23, 1986

☆ U. S. GOVERNMENT PRINTING OFFICE: 1990 262081 20257

(3)

Supreme Court, U.S.
FILED
DEC 28 1990
JOSEPH F. SPANIOL, JR.
CLERK

No. 90-762

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

THOMAS AND SHARON FREYTAG, JOE AND GLADYS WOMBLE, BERT AND MILDRED TIMM, KENNETH AND CANDACE McCOIN,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY TO BRIEF IN OPPOSITION

KATHLEEN M. SULLIVAN
Counsel of Record
BRIAN STUART KOUKOUTCHOS
1525 Massachusetts Avenue
Cambridge, Massachusetts 02138
(617) 495-4633

RICHARD J. SIDEMAN
MARTHA A. BOERSCH
SIDEMAN & BANCROFT
One Embarcadero Center
Suite 860
San Francisco, California 94111
(415) 392-1960
Counsel for Petitioners

December 28, 1990

BATEMAN & SLADE, INC. BOSTON, MASSACHUSETTS

9

TABLE OF CONTENTS

TABLE OF AUTHORITIES CITED

No. 90-762

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

THOMAS AND SHARON FREYTAG, JOE AND GLADYS WOMBLE, BERT AND MILDRED TIMM, KENNETH AND CANDACE McCOIN,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY TO BRIEF IN OPPOSITION

The government's brief in opposition does not challenge the merits of the Appointments Clause question petitioners have presented. Instead, the brief in opposition adds a new question: whether Appointments Clause objections are waivable. The government contends that Appointments Clause objections — unlike all other structural objections to violations of the separation of powers — are fully waivable, and that waiver of those

objections below precludes this Court's review. See Brief in Opposition ("Opp.Br.") at 13-14.[1]

The government is wrong. Petitioners regard the nonwaivability of Appointments Clause objections as settled by this Court's earlier decisions, most importantly, *CFTC* v. *Schor*, 478 U.S. 833, 850-51 (1986); *Glidden* v. *Zdanok*, 370 U.S. 530, 535-37 (1962); and *Lamar* v. *United States*, 241 U.S. 103, 117-18 (1916). See Pet. 24-26. Each of these cases held that a party's failure to raise a structural separation-of-powers objection below did *not* preclude review on the merits of that constitutional issue by this Court. In the face of this authority, the government offers three arguments for treating Appointments Clause claims as nonetheless fully waivable. Each lacks merit and warrants only brief reply.[2]

[1] In answer to petitioners' statutory argument that the special trial judge below was allowed effectively to *make* the decision of the Tax Court in this case in violation of congressional authority, Petition for Certiorari ("Pet.") at 8-12, the government seeks to deny that the Tax Court's Chief Judge rubber-stamped the special trial judge's report the same day it was received. (Opp.Br. 6 n.5; 7 n.6). The government bases this response on the fanciful speculation (made without record support) that Chief Judge Sterrett had somehow sneaked a peek at the special trial judge's report and the staggering record and given them serious study before the case had even been reassigned to the Tax Court. (GB 6 n.5). The government thus asks this Court to presume regularity in these proceedings, *id.*, while suggesting that the statutorily mandated Tax Court review was in fact conducted in a most irregular manner.

The government's speculation is belied by Tax Court Rule 183, which makes plain that, as one would expect, a special trial judge's report is reviewed only after the case has returned to the Tax Court and been assigned to a particular Tax Court judge. (A91-92). Even the court below admitted what the docket entries confirm — that the Chief Judge adopted the report the very same day it was filed. (A8). *See also* Tax Court Docket Entries for No. 3749-84, Oct. 21, 1987. Since the government cannot bring itself to argue that this reflexive rubber-stamp constitutes meaningful review, the linchpin of its argument on § 7443A(b)(4) disintegrates.

[2] The government also argues at the outset that "petitioners' fact-bound contention that their consent was '[ ]coerced' . . . has a singularly insincere ring in a case, such as this one, where the relief petitioners seek is precisely the retrial they claim '[ ]coerced' their consent to begin with." (Opp.Br. 14) (brackets in original). But there is no reason for the government to take such offense. As Judge (now Justice) Kennedy explained in *Pacemaker Diagnostic*

1. The distinction that the government draws between Appointment Clause objections and challenges to subject matter jurisdiction (Opp.Br. 16) is beside the point, because petitioners do not claim that Tax Court special trial judges lack subject matter jurisdiction. Objections to subject matter jurisdiction are indeed nonwaivable, but they are not the *only* sort of objection that cannot be waived, nor are they the sort of objection at issue here. Rather, petitioners object to trial and effective decision by an officer appointed in violation of the Appointments Clause. Petitioners invoke subject matter jurisdiction only by way of analogy, just as this Court did in *CFTC* v. *Schor* when it held a separation-of-powers claim to be nonwaivable. *See* 478 U.S. at 851 (when " 'the encroachment or aggrandizement of one branch at the expense of the other' . . . . is implicated in a given case, the parties cannot by consent cure the constitutional difficulty *for the same reason that* the parties by consent cannot confer on federal courts subject matter jurisdiction beyond the limits imposed by Article III, § 2.") (emphasis added).

2. The government intimates that *Morrison* v. *Olson*, 487 U.S. 654, 670-71 (1988), somehow held Appointments Clause claims to be waivable. (Opp.Br. 16-17). That decision did no such thing. The government's presentation of *Morrison* is egregiously misleading.

The government's indented quotation from *Morrison* is taken flagrantly out of context. *See* Opp.Br. 16. What this Court held to be "not 'jurisdictional' " and hence "waived" was *not*

Clinic v. *Instromedix*, 725 F.2d 537, 543 (9th Cir.) (en banc), *cert. denied*, 469 U.S. 824 (1984), discussed in the Petition at 27-28, a party who consents to trial before a magistrate, when the alternative is delay or other procedural hardships attendant to trial in an Article III forum, is free upon completion of trial to appeal and to seek a new trial before such an Article III forum — whatever the current prospects for delays or difficulties — on the ground that his supposed "waiver" was not free and voluntary. Petitioners occupy a precisely parallel position here, and they invoke the same right.

defendant Olson's Appointments Clause argument — which the Court duly reviewed on the merits — but rather the *government's* (i.e., prosecutor Morrison's) failure to invoke in a timely fashion a narrow line of precedent that would have barred the defendant from raising his constitutional objections to his citation for contempt before the grand jury. *Morrison*, 487 U.S. at 669-70. That line of cases, beginning with *Blair* v. *United States*, 250 U.S. 273 (1919), relies solely on the special exigencies of the grand jury process to preclude a party held in contempt from disrupting the grand jury by challenging, *at that stage of the proceedings*, the subject matter jurisdiction of the grand jury or the constitutionality of the statute under which the grand jury investigation is being conducted. *See id.* at 282-83. Since prosecutor Morrison had failed to invoke *Blair* in the district court, the proceedings had already been disrupted and the special values served by *Blair* were no longer in issue and certainly insufficient to warrant ignoring the important Appointments Clause objection presented by defendant Olson. In this case, the special exigencies of grand juries have *never* been in issue and therefore the *Blair* rule discussed in *Morrison* has absolutely no bearing on whether petitioners' Appointments Clause claim can be deemed waived.

3. Finally, the government asserts that the Executive Branch itself will police the Appointments Clause, so waiver of such constitutional objections by any other party may be deemed preclusive by the courts without any concern that important separation-of-powers issues will go unresolved. Specifically, the government tries to distinguish *CFTC* v. *Schor* by arguing that "[t]he structural interests protected by the Appointments Clause," unlike the structural interests protected generally by the separation of powers, are ones "that at least one of the parties to every tax dispute (the United States) can be expected to protect." Opp.Br. 18.

This argument has a measure of facile appeal, but it cannot be taken seriously. The Appointments Clause claims resolved

by this Court in *Lamar* v. *United States* and *Morrison* v. *Olson* — that particular appointment mechanisms usurped the Executive appointment power — were raised by criminal defendants, *not* by the government party. In each case, the government party was more interested in preserving the fruits or promises of a particular criminal prosecution than in safeguarding the Constitution's structural integrity.[3]

When it comes to the separation of powers, this Court's guiding principle has always been, in essence, that foxes cannot be trusted to guard henhouses. This Court has never relied exclusively upon the other two branches of government to look after the Constitution's structural blueprints, even when the only apparent injury was to the prerogatives of one of those branches. Both Congress and the Executive have all too often been willing to sell their birthright for a mess of potage — to violate the separation of powers and relinquish certain powers or duties in order to meet some felt necessity or to deal with exigent circumstances. And this Court has consistently struck down such tinkering with the separation of powers even when the challenged device — for example, a one-house legislative veto, or the original Gramm-Rudman budget scheme — had been approved by both Congress and the President. *See INS* v. *Chadha*, 462 U.S. 919 (1983); *Bowsher* v. *Synar*, 478 U.S. 714 (1986). Indeed, the Appointments Clause itself was invoked by this Court to invalidate the Federal Election Campaign Act in *Buckley* v. *Valeo*, 424 U.S. 1 (1976), over the objections of the

[3] Similarly, in this case the Appointments Clause question has been raised by petitioners rather than by the government. Indeed, the Solicitor General is willing to defend the appointment power of the Chief Judge of the Tax Court only if he can be deemed the "Head" of an *Executive* Department; the Tax Court, on the other hand, takes the petition that it can be given appointment power as if it were an Article III "Court of Law." See Pet. 6-7, 15-20. Petitioners are the only voice in this case for the appointment prerogatives that Article II, § 2 preserves for the Article III judiciary, which would be diluted if the Tax Court's appointment powers were to be sustained, as well as the only voice calling for a narrow and straightforward reading of the Constitution's text.

Executive and Legislative Branches that had collaborated on and enacted the law. Thus the Executive Branch cannot, any more than any other party, be relied upon to protect the "institutional interests" served by the Appointments Clause and the Constitution's other structural provisions. *CFTC* v. *Schor*, 478 U.S. at 851. "[N]otions of consent and waiver cannot be dispositive" when the Constitution's checks and balances are in issue. *Id.*

CONCLUSION

In sum, petitioners' Appointments Clause objection has not been and should not be deemed waived; the Court should grant the petition for certiorari. The constitutional question has cast doubt on a major portion of the Tax Court's docket and generated a truly astounding degree of confusion within the Executive Branch itself over the constitutional status of the Tax Court and its special trial judges. In the alternative, the Court should issue the writ on the two questions presented in the petition *and additionally* on the third question presented by the govern-

ment: whether Appointments Clause objections are somehow different from other structural separation-of-powers questions that this Court has already held nonwaivable.

Respectfully submitted,

KATHLEEN M. SULLIVAN
Counsel of Record
BRIAN STUART KOUKOUTCHOS
1525 Massachusetts Avenue
Cambridge, Massachusetts 02138
(617) 495-4633

RICHARD J. SIDEMAN
MARTHA A. BOERSCH
SIDEMAN & BANCROFT
One Embarcadero Center
Suite 860
San Francisco, California 94111
(415) 392-1960
Counsel for Petitioners

December 28, 1990

Supreme Court, U.S.
FILED
MAR 1 1991
OFFICE OF THE CLERK

(4)

No. 90-762

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

THOMAS FREYTAG, ET AL.,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

JOINT APPENDIX

KATHLEEN M. SULLIVAN
Counsel of Record
BRIAN STUART KOUKOUTCHOS
1525 Massachusetts Avenue
Cambridge, Massachusetts 02138
(617) 495-4633

RICHARD J. SIDEMAN
MARTHA A. BOERSCH
SIDEMAN & BANCROFT
One Embarcadero Center
Suite 860
San Francisco, California 94111
(415) 392-1960
Counsel for Petitioners

KENNETH W. STARR
Solicitor General

SHIRLEY D. PETERSON
Assistant Attorney General

GARY R. ALLEN
STEVEN W. PARKS
Attorneys
Department of Justice
Washington, D.C. 20530
(202) 514-2217
Counsel for Respondent

March 1, 1991

Petition for Writ of Certiorari Filed Nov. 13, 1990
Writ Granted Jan. 22, 1991

BATEMAN & SLADE, INC   BOSTON, MASSACHUSETTS

TABLE OF CONTENTS

UNITED STATES TAX COURT

RELEVANT DOCKET ENTRIES*

DOCKET NO. 4934-82

THOMAS L. FREYTAG AND SHARON N. FREYTAG
PETITIONER,

v.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

Date	Filings and Proceedings	Action	Date Served
Mar. 3, 1982	Petition Filed. Fee Paid.		Mar 4, 1982
June 1, 1984	ORDER that Dkt. Nos. 4934-82, 9307-82, 29012-82, 1240-83, 3250-83, 8616-83, 204-84, 3749-84, 7658-84, and 11821-84 are consolidated for discovery, trial, briefing, and opinion. The place of trial is San Francisco, CA and jurisdiction is retained by this division of the Court. (Judge Wilbur) Further, ORDER that the cases are calendared for trial at a Special Session Nov 27, 1984 at San Francisco, CA.		Jan 1, 1984

*Docket entries are presented for the initial petition filed by the Freytags. Entries for the other consolidated test cases are identical.

Date	Filings and Proceedings	Action	Date Served
Jun 19, 1984	HEARING at Atlanta, GA before Judge Wilbur		
Sept 7, 1984	HEARING at Atlanta, GA before Judge Wilbur		
Sept 27, 1984	HEARING at New York, NY before Judge Wilbur		
Oct 10, 1984	HEARING at Washington, D.C. before Judge Wilbur		
Oct 25, 1984	HEARING at Washington, D.C. before Judge Wilbur		
Nov 28, 29, Dec. 3, 5, 6, 7, 10-14, 17, 1984	PARTIAL TRIAL at San Francisco, CA before Judge Wilbur.		
Aug. 1, 1985	HEARING at Washington, DC before Judge Wilbur		
Nov. 4, 5, 1985	PARTIAL TRIAL at Washington, DC before Judge Wilbur.		
Nov 19, 1985	ORDER that case is assigned to S.T. Judge Powell for purposes of conducting further trial on Dec 2, 1985		

Date	Filings and Proceedings	Action	Date Served
Dec. 2, 3, 4, 5, 6, 9, 10, 11, 12, 16, 17, 18, 19, 20, 1985	PARTIAL TRIAL at Washington, D.C., before S.T. Judge Powell.		
Jan. 21, thru 24, 27 thru 31, 1986	FURTHER TRIAL at Washington, DC before S.T. Judge Powell. Continued--See Order		
Mar 3, 4, 5, 1986	HEARING at Washington, D.C. before S.T. Judge Powell.		
Mar 24, 25, 26, 27, 1986	FURTHER TRIAL at Washington, DC before S.T. Judge Powell.		
Apr. 28, 29, 30, May 1, 2, 1986	PARTIAL TRIAL at Washington, DC before S.T. Judge Powell.		
May 20, 21, 22, 1986	TRIAL at San Francisco, CA before S.T. Judge Powell. Continued for		

Date	Filings and Proceedings	Action	Date Served
	further trial--SEE ORDER dated May 28, 1986		
May 28, 1986	ORDER that this case is continued for further trial to a Special Session on Jun 9, 1986 at Washington, DC.		Jun 2, 1986
Jun 9 thru 12 1986	FURTHER TRIAL at Washington, DC before S.T. Judge Powell.		
	(SEE ORDER 10-21-87) SUBMITTED TO S.T. JUDGE POWELL		
Jul 23, 1986	NOTICE of Proposed reassignment. Any motions re: this notice should be filed by Aug 25, 1986.		Aug 4, 1986
Sep 9, 1986	MOTION by Petr at 14965-83 for leave to file Memorandum In Opposition to reassignment of cases out of time (Memorandum in Opposition Lodged)	Granted Sep 15, 1986	Sep 18, 1986
Sep 15, 1986	MEMORANDUM in Opposition by Petr. at 14965-83 to reassignment of cases		Sep 18, 1986

Date	Filings and Proceedings	Action	Date Served
Sep 16, 1986	ORDER that Petrs at 14965-83 file by Oct 3, 1986 a Memorandum		Sep 18, 1986
Oct 3, 1986	MEMORANDUM by Petr. at 14965-83 In Support of Objection to Proposed Reassignment (c/s 10-2-86)		
Oct 10, 1986	ORDER that case is set for hearing re: reassignment of cases on Oct 27, 1986 at Special Session at Washington, D.C.		Oct 10, 1986
Oct 27, 1986	HEARING at Washington, DC before S.T. Judge Powell. Hearing held on Proposed reassignment filed 7-23-86. Record held open to 11-10-86 for stipulation as to proposed reassignment.		
Nov 5, 1986	ORDER that case is no longer assigned to Judge Wilbur and is assigned to S.T. Judge Powell (See Order 10-21-87)		Nov 12, 1986
Nov 17, 1986	STIPULATION in all cases except 14965-83. (File Per Judge)		

Date	Filings and Proceedings	Action	Date Served
Feb 5, 1987	ORDER that 14965-83 is severed from consolidation		Feb 10, 1987
Jun. 22, 1987	STIPULATION re: reassignment to S.T. Judge Powell (File per Judge) (See ORDER 10-27-87)		
Oct 21, 1987	ORDER case is reassigned to Judge Sterrett OPINION, Judge Sterrett. 89 T.C. No. 6 (Adopting the Opinion of S.T. Judge Powell) (Decision will be entered under Rule 155)		Oct 21, 1987
Oct 27, 1987	ORDER case reassigned to S.T. Judge Powell		Oct 28, 1987
Oct 30, 1987	ORDER, opinion filed 10-21-87 is herein amended		Nov 3, 1987
Jan 4, 1988	MOTION by Petr. to reconsider opinion (P.M. timely)	Jan 7, 1988	Jan 12, 1988
Jul 7, 1988	ORDER Petrs. motion filed 1-4-88 is denied		Jul 11, 1988

Date	Filings and Proceedings	Action	Date Served
Aug 30, 1988	MOTION by Petr. for reconsideration of Opinion	See Order Nov. 3, 1988	Sep 2, 1988
Nov 3, 1988	ORDER motion filed 8-30-88 is denied. Parties by 12-5-88 file Rule 155 documents		Nov 4, 1988
Mar 10, 1989	DECISION ENTERED, Judge Nims.		Mar 10, 1989

UNITED STATES TAX COURT
Washington, D. C. 20217

THOMAS L. FREYTAG AND SHARON N. FREYTAG, ET AL., Petitioners,	)	First Western Government Securities Inc. Cases
v.	)	
COMMISSIONER OF INTERNAL REVENUE, Respondent.	)	Docket Nos. 4934-82 9307-82 27146-82 29012-82 1240-83 3250-83 8616-83 14965-83 33016-83 204-84 3749-84 7658-84 11821-84

NOTICE OF PROPOSED REASSIGNMENT

Judge Richard C. Wilbur, to whom the above-captioned cases were assigned and before whom these same cases were partially tried, retired as an active judge on the Court due to physical disability and immediately assumed senior status, effective April 1, 1986. By direction of the Chief Judge, Special Trial Judge Carleton D. Powell completed the trial of these cases. This will serve as notice to the parties that these cases will be reassigned to Special Trial Judge Carleton D. Powell for purposes of preparing the report pursuant to Rule 183 of this Court's Rules. It is further contemplated that all other cases involving the same issue, which are presently assigned

to Judge Wilbur, will be reassigned to Special Trial Judge Powell.

If any motions are contemplated with respect to this reassignment, they should be filed on or before August 25, 1986. If no motions are received by the Court by that date these cases will be reassigned to Special Trial Judge Powell and pursuant to Rule 183(c) of the Court Rules, action on this report will be taken by Judge Wilbur, or if not by this Division of the Court.

Samuel B. Sterrett
Chief Judge

Dated: Washington, D. C.
July 23, 1986

TROUTMAN, SANDERS, LOCKERMAN & ASHMORE
A PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS
ATTORNEYS AT LAW
ONE RAVINIA DRIVE
SUITE 1600
ATLANTA, GEORGIA 30346
404 / 650-5000

ROBERT M. FINK, P.C.

August 14, 1986

The Honorable Samuel B. Sterrett
Chief Judge
United States Tax Court
400 Second Street, N.W.
Washington, D.C. 20217

Re: Freytag, et al v. Commissioner

Dear Judge Sterrett:

During our last two conferences regarding the options available to the petitioners, you have agreed to review the decision by Judge Powell in the event Judge Wilbur would not be able to review the decision. You agreed to review the decision in order to alleviate the concern of the petitioners as to the uncertainty of a judge being assigned to review the decision several months after the petitioners agreed to go forward.

As I mentioned to you during our last meeting on July 22, 1986, the attorneys for the test case petitioners consider the agreement by you to review the decision in the event Judge Wilbur is not available, an important element of the agreement to go forward. Accordingly, counsel have represented to their

clients, including the test case petitioners and other First Western Government Securities petitioners, that this is the procedure that the Court has agreed to.

The Notice of Proposed Reassignment dated July 23, 1986, indicated that if Judge Wilbur were not available to review the decision by Judge Powell, action would be taken "by this Division of the Court". We are assuming that such statement is intended to provide for your review of the decision. If we are incorrect in our assumption, I therefore respectfully request that the Notice of Proposed Reassignment be amended to reflect our agreement.

Very truly yours,

/s/ ____________________
Robert M. Fink

RMF:rm
cc: Steve Miller, Esquire
Test Case Attorneys
Richard Sideman, Esquire

UNITED STATES TAX COURT
WASHINGTON, D.C. 20217

THOMAS L. FREYTAG AND	)	Docket Nos. 4934-82
SHARON N. FREYTAG, ET AL.,	)	9307-82
Petitioners,	)	27146-82
v.	)	29012-82
COMMISSIONER OF IN-	)	1240-83
TERNAL REVENUE,	)	3250-83
Respondent.	)	8616-83
		14965-83
		33016-83
		204-84
		3749-84
		7658-84
		11821-84
		First Western Govt.

ORDER

Upon due consideration and pursuant to Rules 180 et seq., and for cause, it is

ORDERED that these cases are no longer assigned to Judge Richard C. Wilbur. It is further

ORDERED that these cases are assigned to Special Trial Judge Carleton D. Powell for trial or other disposition.

(Signed) SAMUEL B. STERRETT
Chief Judge

Dated: Washington, D.C.
November 5, 1986

UNITED STATES TAX COURT

THOMAS L. FREYTAG AND	)	First Western Govern-
SHARON N. FREYTAG, ET AL.,	)	ment Securities Inc.
Petitioners,	)	
v.	)	Docket Nos. 4934-82
COMMISSIONER OF IN-	)	9307-82
TERNAL REVENUE,	)	27146-82
Respondent.	)	29012-82
		1240-83
		3250-83
		8616-83
		33016-83
		204-84
		3749-84
		7658-84
		11821-84

STIPULATION

Petitioners and respondent in this proceeding hereby stipulate that each petitioner and respondent, respectively, waive any claim they have under Rule 63 of the Federal Rules of Civil Procedure with respect to reassignment of the above-captioned case to Special Trial Judge Carleton Powell upon the resignation from the Tax Court of Judge Richard C. Wilbur.

WILLIAM J. NELSON
Internal Revenue Service
Chief Counsel

By: ____________________
STEPHEN M. MILLER,
Special Litigation Counsel
Room 3547
1111 Constitution Ave., N.W.
Washington, DC 20204

Dated: June 22, 1987

By: ____________________
ROBERT M. FINK
Troutman, Sanders, Lockerman & Ashmore
One Ravinia Drive, Suite 1600
Atlanta, GA 30346
Counsel on Behalf of the Test Case Petitioners

Dated: June 18, 1987

UNITED STATES TAX COURT
Washington, D.C. 20217

THOMAS L. FREYTAG AND	)	Docket Nos. 4934-82
SHARON N. FREYTAG, ET AL.,	)	9307-82
Petitioners,	)	27146-82
v.	)	29012-82
COMMISSIONER OF IN-	)	1240-83
TERNAL REVENUE,	)	3250-83
Respondent.	)	8616-83
		33016-83
		204-84
		3749-84
		7658-84
		11821-84

O R D E R

For cause, it is

ORDERED that this case is reassigned to the undersigned for disposition.

/s/ ____________________
Samuel B. Sterrett
Chief Judge

Dated: Washington, D. C.
October 21, 1987

UNITED STATES TAX COURT
Washington, D.C. 20217

THOMAS L. FREYTAG AND	)	Docket Nos. 4934-82
SHARON N. FREYTAG, ET AL.,	)	9307-82
Petitioners,	)	27146-82
v.	)	29012-82
COMMISSIONER OF IN-	)	1240-83
TERNAL REVENUE,	)	3250-83
Respondent.	)	8616-83
		33016-83
		204-84
		3749-84
		7658-84
		11821-84
		FIRST WESTERN GOVERNMMENT SECURITIES, INC.

ORDER

Upon consideration of petitioners' Motion for Reconsideration, filed January 4, 1988, and pursuant to the Memorandum Sur Order of Special Trial Judge Carleton D. Powell, attached hereto and served herewith, which the undersigned hereby adopts, it is

ORDERED that petitioners' Motion for Reconsideration is denied.

Arthur L. Nims, III
Chief Judge

Dated: Washington, D.C.
July 7, 1988.

UNITED STATES TAX COURT
WASHINGTON, D.C. 20217

THOMAS L. FREYTAG AND	)	Docket Nos. 4934-82
SHARON N. FREYTAG, ET AL.,	)	9307-82
Petitioners,	)	27146-82
v.	)	29012-82
COMMISSIONER OF IN-	)	1240-83
TERNAL REVENUE,	)	3250-83
Respondent.	)	8616-83
		33016-83
		204-84
		3749-84
		7658-84
		11821-84
		FIRST WESTERN GOVERNMMENT SECURITIES, INC.

ORDER

For the reasons stated in the Memorandum Sur Order of Special Trial Judge Carleton D. Powell, attached hereto and served herewith, which we adopt, it is

ORDERED that petitioners' Motion for Reconsideration of Opinion, filed August 30, 1988, is denied. It is further

ORDERED that the parties shall file decision documents under Rule 155 on or before December 5, 1988.

/s/ ____________________
Arthur L. Nims, III
Chief Judge

Dated: Washington, D.C.
November 3, 1988.

(5)

No. 90-762

Supreme Court
FILED
MAR 1 1991
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

THOMAS AND SHARON FREYTAG, JOE AND GLADYS WOMBLE, BERT AND MILDRED TIMM, KENNETH AND CANDACE McCOIN,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR PETITIONERS

KATHLEEN M. SULLIVAN
Counsel of Record
BRIAN STUART KOUKOUTCHOS
1525 Massachusetts Avenue
Cambridge, Massachusetts 02138
(617) 495-4633

RICHARD J. SIDEMAN
MARTHA A. BOERSCH
SIDEMAN & BANCROFT
One Embarcadero Center
Suite 860
San Francisco, California 94111
(415) 392-1960
Counsel for Petitioners

March 1, 1991

BATEMAN & SLADE, INC. BOSTON, MASSACHUSETTS

(61)

QUESTIONS PRESENTED

1. Are complex, precedent-setting tax cases affecting thousands of parties and billions of dollars among the "other proceeding[s]" that 26 U.S.C. § 7443A(b)(4) allows the United States Tax Court to assign to a special trial judge for trial and effective resolution?

2. Does the Appointments Clause of Art. II, § 2, cl. 2, which allows Congress to confer power to appoint inferior officers on the "Courts of Law" and the "Heads of Departments," permit Congress to grant the Chief Judge of the Tax Court power to appoint special trial judges?

3. Does a party's consent to have its case heard by a special trial judge constitute a waiver of any right to challenge the appointment of that judge on the basis of the Appointments Clause, Art. II, § 2, cl. 2?

TABLE OF CONTENTS

TABLE OF CONTENTS (cont.)

TABLE OF CONTENTS (cont.)

TABLE OF AUTHORITIES

Cases:

TABLE OF AUTHORITES (cont.)

TABLE OF AUTHORITES (cont.)

***Constitutional Provisions*:**

TABLE OF AUTHORITES (cont.)

***Statutes*:**

TABLE OF AUTHORITES (cont.)

TABLE OF AUTHORITES (cont.)

***Regulations*:**

***Rules*:**

***Legislative Materials*:**

TABLE OF AUTHORITES (cont.)

***Miscellaneous*:**

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit is reported at 904 F.2d 1011 and reprinted as Appendix A.[1] The opinion of the United States Tax Court is reported at 89 T.C. 849 and reprinted as Appendix B.

JURISDICTION

The decision of the Court of Appeals was entered on July 6, 1990. A timely petition for rehearing was denied on August 15, 1990. See Appendix D. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1). A timely Petition for Writ of Certiorari was granted by this Court on January 22, 1991.

CONSTITUTIONAL PROVISIONS, STATUTE AND RULE INVOLVED

The pertinent portions of Art. I, § 8, Art. II, § 2, and Art. III, §§ 1-2 are set forth in Appendix E. The text of 26 U.S.C. § 7443A is set forth in Appendix F. Tax Court Rule 183 is set forth in the Appendix to the Petition at A91-92.

STATEMENT OF THE CASE

At issue here is whether a complex, precedent-setting tax deficiency case involving three thousand taxpayers and approximately $1.5 billion in alleged tax deficiencies may be tried and effectively decided by a "special trial judge" appointed by the Tax Court, rather than by a duly-appointed judge of the Tax Court itself. Petitioners contend that the assignment and decision below exceed the statutory authority of a special trial judge, and that even if Congress has permitted such an assignment, the Constitution does not, for special trial judges are

[1] All appendix citations are to the appendices bound with the Petition for Writ of Certiorari unless otherwise noted. Page citations to the appendices in the Petition will be styled "A____." Page citations to the Joint Appendix will be styled "JA____."

appointed in violation of the Appointments Clause of the Constitution, Art. II, 2, cl. 2.

1. The Tax Court

In 1969 Congress "established, under Article I of the Constitution of the United States, a court of record to be known as the United States Tax Court." 26 U.S.C. § 7441.[2] The court consists of 19 judges appointed by the President with the advice and consent of the Senate to 15-year terms. *See* 26 U.S.C. § 7443(a),(b) and (e); (A73). The Tax Court's predecessor, known as the Board of Tax Appeals, was neither an Article I court nor an Executive Department, but "an independent agency in the Executive Branch of the Government." Internal Revenue Code of 1954, 26 U.S.C. § 7441 (1958).[3] One of the primary purposes of the 1969 legislation was to strip the Tax Court of its previous "constitutional status as an executive agency, no matter how independent." S.Rep. No. 552, 91st Cong., 1st Sess. 302 (1969) ("Since the Tax Court has only judicial duties, . . . it is anomalous to continue to classify it with quasi-judicial executive agencies that have rule-making and investigatory functions.").

2. Special Trial Judges

"Special trial judges," in contrast to regular Tax Court judges, are appointed not by the President but rather by the Chief Judge of the Tax Court pursuant to 26 U.S.C. § 7443A(a). (A100). They number 14, and preside over fully 42% of the

[2] Section 7441 is a codification of § 951 of the Tax Reform Act of 1969, Pub.L.No. 91-172, 83 Stat. 730.

[3] The Board was originally established in 1924. *See* § 900 of the Revenue Act of 1924, 68th Cong., 1st Sess., c. 234, 43 Stat. 253. Although its title was changed to "the Tax Court of the United States" in 1942, *see* § 509 of the Revenue Act of 1942, 77th Cong., 2d Sess., c. 619, 56 Stat. 957, it remained until 1969 an "agency in the Executive Branch." *See* Internal Revenue Code of 1954, 26 U.S.C. § 7441 (1958).

Tax Court's docket pursuant to 26 U.S.C. § 7443A(b)&(c).[4] Special trial judges are appointed to indefinite terms, 26 U.S.C. § 7443A(a), but in practice may serve for as long or longer than the 15-year statutory term of a regular Tax Court judge.[5]

The office of "special trial judge" grew out of a Tax Court practice that began in 1943, when Congress authorized the Chief Judge of the court "from time to time by written order, [to] designate an attorney from the legal staff of the court to act as a commissioner in a particular case," subject to "such rules and regulations as may be promulgated by the Tax Court."[6] Tax Court rules permitted commissioners to prepare a report of proposed findings of fact to which the parties could file exceptions and which was reviewed by a division of the Tax Court. Tax Court Rule 48 (1958). However, the designation of staff attorneys on an *ad hoc* basis to conduct hearings and prepare proposed factual findings was opposed by most Tax Court judges and therefore rarely used. See H. DuBroff, *The United States Tax Court: An Historical Analysis* 346-47 (1979) ("DuBroff").[7] Indeed, for the first five years that the Tax Court enjoyed the power to designate its staff lawyers to act as commissioners, not a single designation was ordered. *See id.* at 346. The prevailing view was that designation of commissioners "would not result in any substantial savings of time because the judges were still required to study the record in order to reach a decision and prepare an opinion," since a

[4] Out of the 54,428 cases pending in the Tax Court on February 28, 1990, special trial judges had been assigned 8,781 small tax cases pursuant to 26 U.S.C. §§ 7443A(b)(2) & (3) and 14,500 complex so-called tax shelter cases pursuant to § 7443A(b)(4). (A73).

[5] The United States Tax Court Reports reveal that at least one current special trial judge has served for 21 years and that at least two others have served for 12 years or longer.

[6] Internal Revenue Code of 1939, 26 U.S.C. § 1114, as amended by § 503 of the Revenue Act of 1943, Pub.L.No. 78-235, 58 Stat. 21, 72. This provision was codified without substantial change in the Internal Revenue Code of 1954, 26 U.S.C. § 7456(c) (1958).

[7] Professor DuBroff's study was commissioned by the Tax Court. *See* Dubroff at iii.

commissioner "would not be able to convey accurately the 'sense' of the witnesses to the judge charged with the writing of the opinion." *Id.* at 347.

In 1969, in the same legislation that converted the Tax Court into an Article I tribunal Congress provided for a full-time office of "commissioner," later redesignated "special trial judge," and authorized the Tax Court's Chief Judge to "appoint" such officers as the court deemed necessary.[8]

The principal use Congress envisioned for these newly full-time officers was presiding in cases filed under a new, streamlined small case procedure established by the 1969 Act.[9] Simplified, informal procedures were provided "at the option of the taxpayer" and a decision in such a small tax case "would not be a precedent for future cases and would not be reviewable on appeal." S.Rep. No. 91-552 at 303; 26 U.S.C. § 7463(a) &(b). (A93). Using special trial judges to hear these cases would facilitate "a procedure whereby the taxpayers with relatively small claims may have reasonable access to the Tax Court without impairing the Court's ability to deal with" its burgeoning caseload. S. Rep. No. 91-552 at 303; *see id.* at 302, 304; DuBroff at 349-50 & n.407.

In 1974 Congress authorized the Tax Court to assign special trial judges to hear a new category of declaratory judgment actions relating to employee pension plans, and even to allow them actually to make the decision of the Tax Court in those

[8] Section 958 of the Tax Reform Act of 1969, Pub.L.No. 91-172, 83 Stat. 487, 734. This provision was originally codified at 26 U.S.C. § 7456(c), but it has been recodified, as amended, at 26 U.S.C. § 7443A. The current title of "special trial judge" formally replaced the previous title of "commissioner" in 1984, *see* Tax Reform Act of 1984, Pub.L.No. 98-369, § 464, 98 Stat. 494, 824, although commissioners had commonly been referred to in Tax Court parlance as special trial judges since this appointed office was established by Congress in 1969. *See, e.g.*, Dubroff at 350 & n.409. For convenience, petitioners will reflect this practice by referring to the post-1969 "appointed" officers as "special trial judges" and to their pre-1969 "designated" staff attorney predecessors as "commissioners."

[9] Section 957 of the Tax Reform Act of 1969, Pub.L.No. 91-172, 83 Stat. 487, 734. This provision was and continues to be codified at 26 U.S.C. § 7463.

cases.[10] In 1976 Congress empowered special trial judges to hear and decide additional, enumerated declaratory judgment cases (involving classification of charitable organizations).[11] Although this "authorization to use [special trial judges] was designed to provide the Tax Court with flexibility in the event of a large number of cases," it was understood that such use would probably "be limited to the hearing and deciding of cases involving issues similar to those in other cases that have previously been heard and decided by judges of the court." DuBroff at 351. *See* H.R. Rep. No. 1280, 93d Cong., 2d Sess. 332 (1974).

In 1978 Congress again expanded the authority of special trial judges to hear and "make the decision" of the Tax Court in additional enumerated declaratory judgment actions, and for the first time granted special trial judges authority formally to "make the decision" of the Tax Court in small tax cases as they could already do in declaratory judgment actions.[12] Such decisions by special trial judges were "subject to such conditions and review as the court may by rule provide," 26 U.S.C. § 7443A(c), leaving the Tax Court entirely free to decide for itself whether to review such decisions, and if so, to set the standard for review by a rule or directive that the Court was not required to publish.[13]

In 1984, Congress once again expanded the jurisdiction of special trial judges. Prior to that date, the law provided that:

> [T]he Chief Judge of the Tax Court may assign to the Court's [special trial judges] for hearing and decision any declaratory judgment proceeding, any

[10] *See* The Employee Retirement Income Security Act of 1974, Pub.L.No. 93-406, § 1041(a), 88 Stat. 829; DuBroff at 351.

[11] *See* The Tax Reform Act of 1976, Pub.L.No. 94-455, §§ 1042, 1306, 90 Stat. 1717.

[12] *See* Revenue Act of 1978, Pub.L.No. 95-600, §§ 336(b)(1), 502(b), 92 Stat. 2841 & 2879. These provisions were originally consolidated and codified at 26 U.S.C. § 7456(d), and then recodified at 26 U.S.C. § 7443A. (A100).

[13] *See* H.R. Conf. Rep. No. 1800, 95th Cong., 2d Sess. 278 (1978).

> small tax case proceeding, and any other proceeding where the amount in dispute does not exceed $5,000, subject to such review as the Court may provide.

H.R.Rep. No. 432, 98th Cong., 2d Sess. 1568 (1984). In order "to clarify that additional proceedings may be assigned to [special trial judges] so long as a Tax Court judge must enter the decision," *id.*, Congress added the provision now found in § 7443A(b)(4), allowing the Tax Court to assign a special trial judge to hear "any other proceeding which the Chief Judge may designate." (A100).[14] Despite the sweeping language of that provision, Congress deemed its addition to be merely

> [a] technical change . . . made to allow the Chief Judge of the Tax Court to assign any proceeding to a special trial judge for hearing and to write proposed opinions, subject to review and final decision by a Tax Court judge, regardless of the amount in issue. However, special trial judges will not be authorized to enter decisions in this latter category of cases.

H.R.Rep. No. 98-432 at 1568.

The Tax Court has set forth the standard under which it reviews the report of a special trial judge in Tax Court Rule 183: a special trial judge submits a "report, including his findings of fact and opinion," to the Tax Court, which may "adopt . . . or modify it" but may *not* provide *de novo* review of the evidence, because the "findings of fact recommended by the special trial judge *shall be presumed to be correct*." Tax Court Rule 183(b)-(c) (A91-92) (emphasis added). The only court to have construed this Rule interpreted it as limiting Tax Court

[14] *See* Tax Reform Act of 1984, Pub.L.No. 98-369, § 463(a), 98 Stat. 494, 824 (1984). The jurisdiction of the special trial judge was originally codified at 26 U.S.C. § 7456(c)&(d), but in 1986 these subsections were recodified without significant change at 26 U.S.C. § 7443A(b)(1) - (b)(4). *See* Tax Reform Act of 1986, Pub.L.No. 99-514, § 1556, 100 Stat. 2085, 2754-55 (1986).

review of special trial judge findings of fact to the highly deferential "clearly erroneous" standard. *See Stone* v. *Commissioner*, 865 F.2d 342, 344-47 (D.C. Cir. 1989). In practice, special trial judge factual findings and legal opinions are routinely adopted verbatim by the regular Tax Court judges to whom they are assigned.[15]

A special trial judge also wields a substantial portion of the Tax Court's other powers. He may rule on all pretrial and trial motions without any review by the Tax Court; may compel the production of evidence, swear witnesses, and issue subpoenas; may "do all acts and take all measures necessary or proper for the efficient performance of his duties;" and "may exercise such further and incidental authority . . . as may be necessary for the conduct of trials or other proceedings." Tax Court Rule 181.[16] As interpreted below (A7) and by the Tax Court itself (A76-78), 26 U.S.C. § 7443A allows a special trial judge to preside over *any* Tax Court case, to formally enter the decision in many narrow and minor tax matters, and to issue findings and opinions that may be adopted verbatim by the Tax Court without meaningful review even in the most complex, significant and far-reaching cases, as they were here.

As a consequence of the 1984 amendment, the Tax Court has transferred a huge and ever-increasing portion of its work to its 14 special trial judges, who now preside over fully 42% of the court's docket, including over 14,500 "tax shelter" cases involving complex tax issues and billions of dollars, which alone constitute 26% of the Tax Court's total caseload.

3. The Proceedings Below

Petitioners' cases are among three thousand taxpayer petitions pending in the Tax Court that raise the issue whether

[15] Indeed, the only published Tax Court decision overruling the factual findings of a special trial judge was *Rosenbaum* v. *Comm'r*, 45 T.C.M. (CCH) 825 (1983), which was promptly reversed for failure to defer to the special trial judge's opinion. *Stone* v. *Comm'r*, 865 F.2d at 347.

[16] The complete Tax Court Rules may be found in 26 U.S.C.A. following § 7453 (1989).

losses incurred on certain forward contracts may be claimed as deductions. (A2, A14).[17] These cases were assigned to Tax Court Judge Richard C. Wilbur, who established a "test case" procedure in which ten cases (including petitioners') were selected for consolidated discovery, trial, briefing and decision. (A5, A15) (JA 1). Trial commenced in late 1984 but was repeatedly interrupted by Judge Wilbur's illness. In November 1985, Chief Judge Samuel Sterrett assigned Special Trial Judge Carleton Powell to preside over the trial as an evidentiary referee; the proceedings were videotaped so that Judge Wilbur could view the evidence at home and prepare his findings and opinion upon recovery. (A5-6) (JA 2).

Judge Wilbur's illness forced his retirement in April 1986. (A6, A72). In July 1986, the Chief Judge notified the parties that he would assign their cases to Special Trial Judge Powell for preparation of findings and an opinion to be submitted to Judge Wilbur, unless anyone objected to this assignment. (A6) (JA 8-9). Petitioners consented to this reassignment only on the express condition that the special trial judge's report be submitted to (and the case ultimately decided by) Judge Wilbur or Chief Judge Sterrett. (A6) (JA 9, 10-11).[18] By that time, Special Trial Judge Powell had already presided over nine weeks of trial as an evidentiary referee. (JA 3-4).

The case was reassigned to Chief Judge Sterrett when Special Trial Judge Powell filed his proposed findings and opinion with the Tax Court on October 21, 1987, disallowing all of petitioners' investment loss deductions. (JA 6, 15). The special trial judge's filing of his report and its verbatim adoption by Chief Judge Sterrett appear from the record to have been virtually simultaneous. The order reassigning the matter to Chief Judge Sterrett and his own opinion adopting the report were typed together on the very same line of the docket sheet and

[17] Petitioners invoked the jurisdiction of the Tax Court pursuant to 26 U.S.C. § 6213.

[18] One corporate taxpayer, Wilhide, Inc., objected to the reassignment in August 1986. That case was severed and is not at issue here. (JA 6).

simultaneously served on the parties that very same day. (JA 6). Thus Chief Judge Sterrett — who had heard none of the 14 weeks of complex financial testimony spanning two years of trial, nor could possibly have had time to review the 9,000 pages of transcript and the 3,000 exhibits — adopted the special trial judge's opinion verbatim and entered it as the Tax Court's decision. (A6, A7) (JA 6).

Petitioners appealed the Tax Court decision to the Court of Appeals for the Fifth Circuit, arguing, *inter alia*, that the decision was invalid because the governing statute, 26 U.S.C. § 7443A, did not allow the Tax Court to assign this complex tax case to a special trial judge for hearing and effective resolution. On July 6, 1990, the court below held that since this issue was "in essence, an attack upon the subject matter jurisdiction of the special trial judge, it may be raised for the first time on appeal" (A7), but it rejected the claim on the merits. Although the court found that "the special trial judge filed his report on October 21, 1987" and that the "Chief Judge adopted this report as the Tax Court's opinion and formally filed the decision that same day" (A7), it held that there was no evidence "even remotely suggest[ing]" that the special trial judge effectively decided the case, "other than the short time span between the filing of the special trial judge's report and the issuance of the Tax Court's opinion by its chief judge." (A8). The formalities were sufficient to satisfy the Fifth Circuit: "Our analysis begins and ends with the simple fact that the opinion in this case was issued by the Tax Court in the name of the chief judge." (A7).

Petitioners further argued that the Tax Court's decision was invalid because trial had been conducted and the findings and opinion had been prepared by a special trial judge appointed in violation of the Constitution by the Chief Judge of the Tax Court, who is neither a "Head[ ] of Department[ ]" nor a member of a "Court[ ] of Law" as required by the Appointments Clause, Art. II, § 2, cl.2. The court below declined to reach the merits of this argument, holding that, "[b]y consenting to

the assignment of their case at the time it was made, the Taxpayers waived this objection." (A8 n.9).

4. The Related Proceedings in *Samuels, Kramer & Co.* v. *Comm'r.*

After the appeal to the Fifth Circuit had been filed but before that court rendered its decision on July 6, 1990, another group of taxpayers raised these same arguments in the Tax Court in the related case of *Samuels, Kramer & Company* when the Tax Court likewise assigned that case to Special Trial Judge Powell. (A72-73).[19] On April 9, 1990, the Tax Court held that it could constitutionally appoint special trial judges because it was a "Court[ ] of Law" within the meaning of the Appointments Clause. (A83-86). The Tax Court certified its order for interlocutory appeal (A89, A96) and the Court of Appeals for the Second Circuit granted Samuels' motion for leave to appeal. *Samuels, Kramer & Co.* v. *Commissioner*, Nos. 90-4060/90-4064 (pending, 2d Cir.).

Oral argument was held on October 24, 1990. The Commissioner (respondent here) was represented by the Solicitor General of the United States, who argued that the Chief Judge of the Tax Court constitutionally wields appointment power as the "Head" of a duly-constituted Executive "Department," but that the Tax Court certainly cannot be deemed a "Court of Law" within the meaning of the Appointments Clause. The opposing position that the Tax Court is not an Executive Department but a "Court of Law," was presented by former Solicitor General Erwin N. Griswold, appearing as *amicus curiae* on his own behalf.

[19] Samuels, Kramer & Co. was the investment advisor for the firm with which the petitioners had their investment accounts. (A72). In the Tax Court the case was captioned *First Western Government Securities, Inc., et al.* v. *Commissioner*, 94 T.C. 32 (1990). This opinion is reprinted as Appendix C.

5. The Government's Shifting Position In This Case

While litigating this case and the related case of *Samuels, Kramer & Co.*, the Justice Department has staked out a bewildering variety of positions on the constitutional status of the Tax Court under the Appointments Clause. In the fall and winter of 1989, the government contended in the Fifth Circuit that the Tax Court qualifies as a "Court of Law" that may be vested with appointment power under Art. II, § 2, cl.2. However, the government soon discovered that President Bush, when signing legislation authorizing the Article I Claims Court to appoint special masters analogous to Tax Court special trial judges, had stated on December 19, 1989 that the appointment of inferior officers by such Article I tribunals violated the Appointments Clause. (A103). While *Freytag* was pending before the Fifth Circuit, the government wrote to that court admitting that its constitutional analysis was "in tension" with the President's position. (A102).

Meanwhile, the Tax Court in *Samuels, Kramer* declined to be characterized as an Executive "Department" and held itself to be a "Court of Law" under the Appointments Clause. (A83-86). The Solicitor General then argued to the Second Circuit in that case that the Tax Court is definitely not a "Court of Law" but rather a "Department" within the Executive Branch.

On January 22, 1991, this Court granted a writ of certiorari to the Court of Appeals for the Fifth Circuit and directed the parties to brief the additional question whether a challenge under the Appointments Clause can be waived by consent to a hearing before a special trial judge.

SUMMARY OF ARGUMENT

Since 1969, when the Tax Court was established as an Article I court, it has made ever-increasing use of "special trial judges" appointed by the Chief Judge of the Tax Court to hear and resolve its cases. Tax Court work is now almost evenly divided between the presidentially appointed regular judges,

who number 19 and serve for 15-year terms, and the special trial judges, who number 14 and preside over fully 42% of the Tax Court docket. Special trial judges are assigned not only to narrow declaratory judgment cases and small tax claims, but also to even the most lengthy, complex, and precedent-setting tax deficiency controversies, such as the 3,000-party, $1.5 billion "tax shelter" case below.

This practice far exceeds the bounds of the statutory authority Congress has conferred upon the Tax Court. The statute governing the use of special trial judges, 26 U.S.C. § 7443A, codifies 15 years of careful, specific, and incremental grants of power by Congress. Between 1969 and 1984, Congress authorized the Tax Court to assign special trial judges, with the taxpayer's consent, to hear and later to make formal decisions in small tax claims. Authority was later given to hear and make formal decisions in a variety of declaratory judgment actions. The legislative history of these developments makes clear that Congress intended special trial judges to aid the regular Tax Court judges by presiding over narrow, repetitious or minor matters, not to function as full-fledged surrogates for the Tax Court judges themselves.

Yet the court below read a 1984 amendment to the statute to effectively elevate the special trial judges to just that status. Section 7443A(b)(4) of Title 26 of the U.S. Code, which codifies the 1984 amendment, authorizes the Chief Judge to assign special trial judges "to any other proceeding the chief judge may designate," in addition to the narrow declaratory judgment and small tax cases enumerated in subsections (b)(1)-(3). The court of appeals read this language literally, as giving the Tax Court a blank check to assign to special trial judges even its most complex and challenging cases.

This holding should be rejected, and (b)(4) read far more narrowly. Subsection (b)(4), which Congress deemed a mere "technical change," should not be construed to have licensed the wholesale transfer of effectively dispositive power to special trial judges. It makes no provision for taxpayer consent, and specifies no standard for Tax Court review — in sharp contrast, for example, to the statutes governing federal magistrates. The court below took comfort from the fact that special trial judges may not formally enter their own findings and opinions in (b)(4) cases, but may do so only under the signature of a regular Tax Court judge. But no such solace is justified, for the Tax Court's own rules guarantee that the special trial judge will effectively decide (b)(4) cases: special trial judge findings of fact must be "presumed to be correct," and in "tax shelter" cases like this one, the facts are everything.

Even if the governing statute is read broadly to authorize the assignment to the special trial judge below, the Constitution bars that assignment. For the Appointments Clause, Art. II, § 2, cl.2, permits Congress to vest the power to appoint inferior officers only in the President, the "Heads of Departments," or "the Courts of Law." Special trial judges are without doubt "inferior officers," but the Tax Court, a specialized Article I tribunal, is neither a "Department" nor a "Court of Law."

The purpose of the Appointments Clause was to limit the diffusion of the awesome power to appoint officers, and to distance such power from the Legislature. The Clause achieves these goals by allowing Congress to confer power to appoint inferior officers only on two groups of officials: first, the President himself and his "Heads of Departments," who are accountable to the President's own electoral constituency and who enjoy political and constitutional checks preserving their independence from Congress; and second, the "Courts of Law," who are protected by the tenure and salary provisions of Article III.

The Tax Court does not fit within the language or fulfill the purposes of the Appointments Clause. The term "Department" has consistently been interpreted by the Framers and by this Court, at each of the several places it appears in the Constitution, to refer exclusively to the great, Cabinet-level Executive Departments, and not to any lesser bureau or tribunal. Simi-

larly, the term "Courts of Law" has been understood to refer exclusively to the only other courts mentioned in the Constitution — the Article III courts, which possess the necessary independence from Congress to wield appointment power. If either of these constitutional terms were stretched to include a specialized Article I forum such as the Tax Court, then the Appointments Clause would cease to impose any meaningful limit on congressional latitude to confer appointment power on nearly any organ of the federal government outside the Legislative Branch.

Fortunately, the availability of a reasonable but far more narrow interpretation of 26 U.S.C. § 7443A(b)(4) obviates the need to confront this grave constitutional question. For if (b)(4) is construed to prevent the assignment of a complex tax case such as this one to a special trial judge, the constitutional issue may be avoided.

If the Court nevertheless finds it necessary to resolve the Appointments Clause issue, it may do so — because that issue cannot be and has not been waived. This Court has consistently held that an objection to a judicial proceeding predicated on one of the Constitution's *structural* principles, in contrast to the assertion of a *personal* right guaranteed by the Constitution, is too important to be left to the vagaries of individual litigation strategies. The parties in a lawsuit can waive their own procedural rights but they cannot "consent" to a violation of the Constitution's structural plan. An Appointments Clause challenge is purely structural and has no personal rights component at all.

Even if Appointments Clause objections were sometimes waivable, the supposed "consent" below cannot be deemed free and voluntary. In contrast to the regime under which federal magistrates operate in the District Courts, the statutes and rules governing the assignment of (b)(4) cases to special trial judges do not require taxpayer consent and hence make no provision for ensuring that such consent is knowing, free, and voluntary, especially when the assignment occurs not at the

outset of the proceeding but only after trial has gone on for months. Moreover, under the particular circumstances of this case, petitioners' acceptance of the belated, mid-trial assignment to a special trial judge cannot be deemed voluntary, for the coercive alternative was to scrap one of the longest trials in Tax Court history and begin all over again. That Hobson's Choice was no choice at all, and petitioners' "consent" therefore should not prevent this Court from considering petitioners' structural constitutional claim.

The systemic interest in maintaining the constitutional plan of separation of powers has often led this Court to reach and decide issues not considered in the courts below. Since the Appointments Clause issue was raised in the Court of Appeals and has now been fully briefed by the parties, the Court should proceed to decide it, and reverse the judgment below. The constitutional flaw is easily remedied by remand for a new trial before a properly appointed Tax Court judge. And if the Tax Court requires additional manpower, the most obvious solution is for Congress openly to expand the number of presidentially appointed Tax Court judges, just as Congress periodically does with District Court judges, *not* for the Tax Court to appoint its own surrogates, with neither the careful scrutiny nor the public accountability that accompany appointment by the President.

ARGUMENT

I. CONGRESS HAS NOT AUTHORIZED SPECIAL TRIAL JUDGES TO HEAR AND EFFECTIVELY RESOLVE COMPLEX TAX CASES INVOLVING UNSETTLED LEGAL ISSUES, THOUSANDS OF PARTIES AND BILLIONS OF DOLLARS.

This Court has long adhered to the "cardinal principle" that, "where an otherwise acceptable construction of a statute would raise serious constitutional problems, the Court will construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress." *DeBartolo Corp.*

v. *Fla. Gulf Coast Bldg. & Constr. Trades Council*, 485 U.S. 568, 575 (1988). The statutory construction below plainly raises "serious constitutional problems" under the Appointments Clause (see Part II, *infra*) — so serious as to have driven the federal government itself into profound internal disarray. This problem may be readily avoided by a more narrow interpretation of the statute.

This Court's "reluctance to decide constitutional issues is especially great where, as here, they concern the relative powers of coordinate branches of government." *Public Citizen* v. *Dept. of Justice*, 109 S.Ct. 2558, 2572 (1989). Accordingly, this Court in recent Terms has avoided a number of serious separation-of-powers questions by construing federal statutes narrowly. For example, in *Public Citizen*, the Court read the Federal Advisory Committee Act not to apply to advice given by a standing committee of the American Bar Association to the Justice Department about federal judicial nominations, thus avoiding the need to decide whether the Act intruded upon presidential nomination prerogatives under the Appointments Clause. *See* 109 S.Ct. at 2560, 2572-73. Similarly, in *Coit Independent Joint Venture* v. *FSLIC*, 109 S.Ct. 1361 (1989), the Court read the statutes governing the Federal Savings and Loan Insurance Corporation (FSLIC) not to preclude *de novo* judicial consideration of state-law claims against insolvent savings and loan associations that had been placed in FSLIC receivership, thus avoiding the question whether such preclusion would violate Article III. *See id.* at 1371. And in *Gomez* v. *United States*, 109 S.Ct. 2237 (1989), the Court construed the Federal Magistrates Act, 26 U.S.C. § 631 *et seq.*, not to permit magistrates to conduct felony trial jury voir dire, thus likewise avoiding a serious question under Article III. *See id.* at 2246 n.25.

In this case, as in *Public Citizen*, *Coit* and *Gomez*, a vexing structural constitutional question will be presented unless this Court construes the statute more narrowly than did the court below. The Fifth Circuit read 26 U.S.C. § 7443A(b)(4) to confer upon special trial judges appointed by the Tax Court a

scope of jurisdiction fully coextensive with that of presidentially appointed Tax Court judges — so long as special trial judge opinions in (b)(4) cases are formally "issued by the Tax Court in the name of" a regular Tax Court judge. (A7). Such a construction would permit a special trial judge to hear and effectively decide literally *any* Tax Court case, no matter how many parties were affected, no matter how complex or unsettled the legal issues, and no matter how broad the precedential effect. If the statute is so construed, and the assignment to the special trial judge below is thus deemed permissible under the statute, then a thorny constitutional question under the Appointments Clause will necessarily be presented.

Fortunately, however, a "construction of the statute is fairly possible by which the [constitutional] question may be avoided." *Crowell* v. *Benson*, 285 U.S. 22, 62 (1932). For here, as in *Gomez*, "a reasonable alternative interpretation pos[ing] no constitutional questions . . . readily may be deduced from the context of the overall statutory scheme." 109 S.Ct. at 2241.

A. The "Any Other Proceeding" Language Of 26 U.S.C. § 7443A(b)(4) Must Be Read In Light Of The Narrow Grants Of Jurisdiction in §§ (b)(1)-(3).

The Tax Court and the Fifth Circuit have misinterpreted § 7443A(b)(4) by reading it in isolation from adjoining provisions and outside the context of two decades of measured congressional development of special trial judge jurisdiction. This Court does not always read expansive language such as § 7443A(b)(4)'s reference to "any other proceeding" to mean what, in isolation, it literally says. "Where the literal reading of a statutory term would 'compel an odd result,' we must search for other evidence of congressional intent to lend the term its proper scope." *Public Citizen*, 109 S.Ct. at 2566. In *Gomez* v. *United States*, 109 S.Ct. 2237 (1989), this Court considered an expansive "catch-all" provision in the Federal Magistrates Act, 28 U.S.C. § 631, that is similar to the "any other proceeding" provision of § 7443A. Despite the broad

language of the Magistrates Act, which permits magistrates to be assigned "such additional duties as are not inconsistent with the Constitution and laws of the United States," 28 U.S.C. § 636(b)(3), this Court unanimously held — without reaching the constitutional question — that magistrates could not conduct felony jury selection, because the catch-all provision had to be read in light of the earlier, specific grants of power:

> When a statute creates an office to which it assigns specific duties, those duties outline the attributes of the office. Any additional duties performed pursuant to a general authorization in the statute reasonably should bear some relation to the specified duties.

Id. at 2241.

This rule is equally applicable here. Section 7443A(a) creates the office of special trial judge and § 7443A(b) specifies the duties of that office to include the handling of declaratory judgments and small tax cases. Complex tax shelter cases involving thousands of parties and unsettled issues of law are not included in this enumeration nor are they in any way related to such minor or limited tax disputes. Therefore, a special trial judge may not preside over them.

This modest view of special trial judge jurisdiction is confirmed by the careful congressional development of that office since 1969. The office of special trial judge was created in 1969 primarily to implement a new small case procedure whose burdens, Congress feared, might "impair[ ] the [Tax] Court's ability to deal with the cases coming before it." S.Rep. No. 91-552 at 303. Simplified, informal procedures were provided, taxpayer consent was required, and the decision in a small tax case "would not be a precedent for future cases and would not be reviewable on appeal." *Ibid.*

Thereafter, as was the case with the Magistrates Act at issue in *Gomez*, came a "gradual congressional enlargement of . . . jurisdiction." 109 S.Ct. at 2245. In 1974, 1976 and 1978, Congress enacted laws authorizing the use of special trial judges

in a variety of declaratory judgment cases, where the record was typically already fully developed in the administrative process and hence the special trial judge would not conduct a full trial, resolve disputed factual issues, or tangle with novel and complex legal issues.[20] Thus Congress authorized the Tax Court to deploy special trial judges to alleviate the burden imposed on the Tax Court by repetitious, narrow or minor tax matters that could keep the court from trying its more complex and challenging cases. *See* DuBroff at 351; H.R.Rep. No. 93-1280 at 332. *Cf. Gomez*, 109 S.Ct. at 2245 (Congress intended magistrates to "handle subsidiary matters to enable district judges to concentrate on trying cases").

The state of special trial judge jurisdiction in 1984 was, as the Tax Court has described it, that "the Chief Judge was authorized to assign to special trial judges *only* 'any declaratory judgment proceeding, any small tax case, and any other proceeding where the amount in dispute [did] not exceed $5,000.' " (A76) (Tax Court in *Samuels, Kramer*, quoting H.R.Rep. No. 98-432) (emphasis added). In 1984 Congress enacted what became § 7443A(b)(4), which allows the assignment to a special trial judge of "any other proceeding which the Chief Judge may designate." (A100). Congress deemed this addition to be a mere "technical change" meant to allow the assignment of cases "regardless of the amount in issue." H.R.Rep. No. 98-432 at 1568. There was absolutely no indication that subsection (b)(4) would now encompass major test cases, such as this tax shelter dispute, where the legal and financial issues are far more complex (and the precedential effect of the decision will be far more sweeping) than in the simple, almost administrative tax matters enumerated in § 7443A(b)(1)-(3).

It is incongrous to assume that Congress intended such a wholesale expansion of special trial judge jurisdiction when it enacted § 7443A(b)(4) after 15 years of measured, incremental

[20] *See* M.Garbis, P.Junghans, S.Struntz, *Federal Tax Litigation: Civil Practice & Procedure* ¶21.02[1] (1985).

and highly specific adjustment of that jurisdiction to include a variety of discrete, simple or minor tax matters.[21] Here, as in *Gomez*, a literal reading of the "any other proceeding" provision simply will not wash. The "carefully defined grant of authority to conduct trials" in "minor" cases "should be construed as an implicit withholding of the authority to preside" over the trial of a complex, major tax shelter case. *Gomez*, 109 S.Ct. at 2245.

B. Even If A Special Trial Judge May Hear A Complex Tax Case, He May Not Effectively Resolve It Subject Only To Deferential Tax Court Review.

The court below read (b)(4) to expand special trial judge jurisdiction dramatically to include power to preside over any and all conceivable cases, regardless of the subject matter or standard of review, so long as a regular Tax Court judge formally enters the decision in the record: "Our analysis begins and ends with the simple fact that the opinion in this case was issued by the Tax Court in the name of the Chief Judge." (A7).

[21] It would be especially implausible to make such an assumption against the backdrop of contemporaneous legislative developments involving similar subordinate or adjunct adjudicatory officers over in the Article III courts. In the period leading up to 1984, Congress had considered at length legislation governing the jurisdiction of federal magistrates and bankruptcy judges. Congress was well aware of the constitutional dangers of giving too much power to such officers under Article III. The 1979 amendments to the magistrate statute confined magistrate jurisdiction within elaborately specified consent and review requirements, in part to ensure that there would be no infringement of Article III. *See Gomez*, 109 S.Ct. at 2243-45. And in the years 1982 to 1984, Congress rewrote the rules for bankruptcy judge jurisdiction in the wake of this Court's decision in *Northern Pipeline Constr. Co.* v. *Marathon Pipe Line Co.*, 458 U.S. 50 (1982). While the appointment of special trial judges by the Tax Court of course raises no issue under Article III, it is unlikely, given the lessons of the magistrate and bankruptcy debates, that Congress would have blithely granted a blank check to special trial judges without so much as a thought to its possible infirmity under the Appointments Clause. This Court in the past has been "loath to conclude that Congress intended to press ahead into dangerous constitutional thickets in the absence of firm evidence that it courted those perils," and should be similarly wary here. *Public Citizen*, 109 S.Ct. at 2572.

Such rigidly formal, literal-minded analysis did not satisfy this Court in *Gomez*, and it should not suffice here. This Court declined to endorse a broad reading of the catch-all provision in the Magistrates Act in *Gomez* because the "district court retains the power to assign to magistrates unspecified 'additional duties,' *subject only to conditions or review that the court may choose to impose*." 109 S.Ct. at 2245 (emphasis added). The lack of meaningful review of magistrate rulings under the expansive, literal reading of the Act urged by the government in *Gomez* was a major factor in this Court's rejection of a broad reading of the law. *See id.* at 2246-47. In particular, this Court repudiated the government's "meritless . . . contention" that "jury selection is among the pretrial matters that a magistrate may 'hear and determine,' subject to review only for mistakes that are clearly erroneous or contrary to law." *Id.* at 2247 n.28.

The standard under which special trial judge opinions and findings are reviewed likewise argues for a narrow reading of the "any other proceeding" language in § 7443A(b)(4). Under § 7443A(c), the Tax Court picks its own standard of review, and it is clear that, as in *Gomez*, the scrutiny imposed is no more searching than a "clearly erroneous" standard. Tax Court Rule 183(c) mandates that special trial judge factual findings "*shall be presumed to be correct*" by the Tax Court judge. (A92) (emphasis added). The only circuit court decision addressing this precise issue has held that special trial judge factual findings are reviewable, at most, under a "clearly erroneous" standard. *Stone* v. *Commissioner*, 865 F.2d 342, 344-47 (D.C.Cir. 1989).[22] As

[22] Contrary to the intimation of the court below (A7-8 n.8), the *Stone* decision has not been superseded by any supposed change in Tax Court practice. Although Tax Court Rules no longer require a special trial judge to file his report with the clerk of the Tax Court so that litigants may file exceptions to it before it is reviewed by a Tax Court judge, *Stone* never even cited, much less relied upon, those provisions of the old rules. Instead, the *Stone* court based its decision solely on what is now Tax Court Rule 183, the text of which has not changed. 865 F.2d at 345. *Stone* remains the law: the Tax Court must adopt the findings of a special trial judge unless clearly erroneous. The government in *Stone* was unable to identify even a single Tax Court decision manifesting a level of review more searching than the "clearly erroneous" standard. *Id.* at 347.

in *Gomez*, a catch-all provision like (b)(4)'s "any other proceeding" clause should not be interpreted to allow assignment of major, complex, precedent-setting tax disputes under such a deferential standard of review.

Indeed, the statutory provisions relating to Tax Court review of special trial judge reports indicate that Congress never authorized the Tax Court to assume a remote supervisory posture in (b)(4) cases such as the one at issue here. Section 7443A(c) authorizes the Tax Court to establish "such conditions and review as the court may provide" for the disposition by special trial judges of small tax cases and declaratory judgment actions assigned under subsections (b)(1), (2) or (3). (A100). No mention is made of the Tax Court enjoying similar power to set the standard for reviewing special trial judge reports under cases assigned pursuant to subsection (b)(4). Here, as in *Gomez*, it is "[s]ignificant[ ]" that Congress "did not identify" (b)(4) cases as those in which the Tax Court was empowered to establish the standard of review. 109 S.Ct. at 2246. "It is incongruous to assume that Congress" meant to give the Tax Court power to set that standard "yet failed even to mention that matter in the statute." *Id.* at 2246-47. The only plausible inference that can be drawn from this pointed omission in § 7443A is that Congress did not intend for Tax Court supervision of special trial judge findings and opinions in (b)(4) cases to be *appellate* in nature. Those cases were meant to be *decided* by the Tax Court *in the first instance*, not merely *reviewed* after a special trial judge heard the case and drafted the opinion.

The application of Tax Court Rule 183's deferential standard of review in this case is therefore beyond the power of the Tax Court. Congress did not give the Tax Court power to act as an appellate tribunal in (b)(4) cases, yet that is clearly what the Tax Court has done. The "clearly erroneous" standard of review mandated by Tax Court Rule 183(c) undoubtedly governs in all assignments to special trial judges, *see Stone* v. *Comm'r*, 865 F.2d at 345, 347, and this highly deferential

standard was expressly applied by the Tax Court in reviewing Special Trial Judge Powell's opinion in this case. (JA 9) (action on Powell's report will be taken "pursuant to Rule 183(c)").

Even assuming that Congress intended to allow special trial judges to preside over complex tax disputes with wide-ranging effect, such as this one, it is inconceivable that Congress meant to allow the Tax Court to adopt special trial judge opinions in (b)(4) cases wholesale, subject only to the deferential standard of review the Tax Court was empowered to establish with respect to (b)(1)-(3) cases.[23] It is simply no answer to say, as did the court below, that the Tax Court can be deemed to make its own decisions in (b)(4) cases, in compliance with the statute and congressional intent, because the decision in such cases is, ultimately, formally "issued by the Tax Court in the name" of a regular Tax Court judge. (A7). This exalts form over substance. In practice, the real standard applied by the Tax Court in (b)(4) cases may be even more deferential than the "clearly erroneous" standard.

This case is a perfect example of how special trial judges routinely do the Tax Court's work with only the most cursory supervision, if any. Findings of fact often conclusively decide tax litigation, as they did in this case, where the issue whether a particular transaction and the deduction claimed for it will be disallowed as a sham "is a question of fact reviewed under the clearly erroneous standard." (A8). Thus Special Trial Judge Powell's conclusion that petitioners' deductions were shams and that additional tax liabilities were owed was virtually binding on the Tax Court. That conclusion was reached after one of the longest trials in Tax Court history, a trial that generated a voluminous record and that raised complex and unsettled issues of tax law. Yet, as the court below found, "the special trial judge filed his report on October 21, 1987" and the "Chief

[23] *Cf. Gomez*, 109 S.Ct. at 2246 ("Even assuming that Congress did not consider *voir dire* to be part of trial, it is unlikely that it intended to allow a magistrate to conduct jury selection without procedural guidance or judicial review.").

Judge adopted this report as the Tax Court's opinion and formally filed the decision that same day" (A7) — thereby deciding test cases meant to determine the fate of over 3,000 similar tax cases involving billions of dollars.

No presumption of administrative regularity can convert this into meaningful review. The Fifth Circuit virtually conceded that the Tax Court review in this case was but a rubber stamp, noting explicitly the "short time span" (A8) — a few hours at the very most — in which the supposed review of the 9,000 page transcript and 3,000 exhibits was accomplished. For the court below to treat this as meaningful review is truly an arid exercise in empty formalism. Although allowing special trial judges to resolve minor tax matters — subject to what review the Tax Court deems appropriate — may comport with the congressional design under § 7443A(b)(1)-(3), the assignment of this complex and far-reaching case to a special trial judge for effectively final resolution is inconsistent with the narrow grant of authority in § 7443A(b)(4) when read in its proper context.

II. THE APPOINTMENT OF SPECIAL TRIAL JUDGES BY THE CHIEF JUDGE OF THE TAX COURT VIOLATES THE APPOINTMENTS CLAUSE.

If § 7443A(b)(4) is read, as it was below, to permit a special trial judge to preside over the trial of *any* Tax Court case, then there is no way of avoiding the question whether the Tax Court's appointment of special trial judges comports with the Constitution. Under the Appointments Clause, Art. II, § 2, cl. 2., the power to appoint inferior officers may be vested by Congress "in the President alone, in the Courts of Law, or in the Heads of Departments." (A99). But the Article I Tax Court is not a "Court[ ] of Law" within the meaning of that clause, nor is its Chief Judge a "Head[ ] of Department."

The Appointments Clause must be understood in light of its history, which reveals the Framers' plan to prevent the wide-

spread diffusion of appointment power throughout the federal government, and to limit congressional discretion to vest power to appoint inferior officers to two groups of officials: on the one hand, the "President himself" and his "Heads of Departments," who are accountable to the President's own electoral constituency and who enjoy political and constitutional checks preserving their independence from Congress; and, on the other hand, the "Courts of Law," who are protected by the tenure and salary provisions of Article III.

As James Madison recognized, the appointment of executive officers was "the most delicate part in the organization of a republican government" and "the most difficult to establish on unexceptionable grounds." 3 *The Debates In The Several State Conventions On The Adoption Of The Federal Constitution* 374 (J. Elliot ed. 1854). The "manipulation of official appointments" had long been the American revolutionary generation's greatest grievance against executive power, G. Wood, *The Creation Of The American Republic 1776-1787* 79 (1969), because "the power of appointment to offices" was deemed "the most insidious and powerful weapon of 18th century despotism." *Id.* at 143. These concerns were addressed in Philadelphia in 1787 by carefully husbanding the appointment power to limit its diffusion, and by dividing the power to appoint principal federal officers (Ambassadors, Ministers, Heads of Departments, Judges) between the Legislative and Executive Branches. *See Buckley* v. *Valeo*, 424 U.S. 1, 129-31 (1976). Even with respect to "inferior Officers," the Framers granted Congress only limited authority to devolve appointment power upon the President, the Courts of Law, and the Heads of Departments.

That limit cannot "be read as merely dealing with etiquette or protocol in describing 'Officers of the United States.'" *Buckley*, 424 U.S. at 125. The "drafters had a less frivolous purpose in mind." *Id.* They were determined to limit the distribution of the power of appointment in order to keep that justifiably fearsome power in check. To that end, the Constitu-

tional Convention rejected Madison's complaint that the Appointments Clause did "not go far enough": Madison argued that "Superior Officers" other than "Heads of Departments ought in some cases to have the appointment of the lesser offices." 2 *Records of the Federal Convention of 1787* 627-28 (M. Farrand ed. 1966).[24]

The Appointments Clause was unanimously approved in its original, limited form, *id.* at 628, and it has served the Republic well for two centuries. When the practical demands of staffing a burgeoning bureaucracy with a proliferation of offices have been felt, Congress has, "as they think proper," Art. II, § 2, cl.2, lodged the appointment power in the politically accountable President or in his immediate subordinates, the Heads of Departments, who serve at the President's pleasure.

Congress has vested appointment power in the Judicial Branch when independence from Executive and Legislative manipulation or pressure has been deemed essential — as in the appointment of inferior judicial officers such as magistrates and bankruptcy judges, or the appointment of executive officers whose duties might engender a conflict of interest if they were appointed by the President or a Head of Department.[25]

The government apparently considers this degree of flexibility insufficient to meet modern conditions, and essentially urges this Court to amend the Appointments Clause so that the appointment power the Framers guarded so jealously can be conferred not just on the Courts of Law and the Heads of Departments, but also on the chief officers of legislative courts. The government thus asks this Court to condone the very

[24] The brief debate on this provision of the Appointments Clause is reprinted in the Appendix at A94-95.

[25] *See, e.g., Morrison* v. *Olson*, 487 U.S. 654, 677 (1988) (independent counsel appointed by special panel of federal Court of Appeals and charged with investigating and prosecuting crimes by President's closest advisors); *Ex Parte Siebold*, 100 U.S. 371, 397 (1879) (election supervisors appointed by federal district courts to police federal elections during Reconstruction); Judiciary Act of Sept. 24, 1789, ch.20, §§ 28-29, 1 Stat. 73, 88 (1789) (Judiciary empowered to appoint U.S. Marshals whenever presidentially appointed Marshal has conflict of interest).

diffusion of appointment power that the Framers intended to forbid. Such a change is both unwarranted and unconstitutional.

A. A Special Trial Judge Is An "Inferior Officer" Whose Appointment Must Conform To The Appointments Clause.

The Appointments Clause governs the appointment of "all persons who can be said to hold an office under the government." *Buckley* v. *Valeo*, 424 U.S. 1, 125 (1976). As the United States Tax Court held in the related *Samuels, Kramer* case, its own special trial judges are indeed inferior officers of the United States, not mere employees. (A79-80). That holding cannot plausibly be contested.

A special trial judge plainly fits this Court's contemporary definition of an "officer" for Appointments Clause purposes, namely, an "appointee exercising significant authority pursuant to the laws of the United States," *Buckley*, 424 U.S. at 126. As set forth above, page 7, special trial judges do a substantial portion of the Tax Court's work and exercise virtually the same powers as presidentially-appointed Tax Court judges. A special trial judge is vested with all "incidental authority . . . necessary for the conduct of trials or other proceedings." Tax Court Rule 181. As interpreted below (A7), 26 U.S.C. § 7443A allows a special trial judge to preside over *any* Tax Court case, to formally enter the decision in many minor or limited tax matters, and to issue findings and opinions that may be adopted verbatim by the Tax Court without meaningful review even in the most complex, significant and far-reaching cases, as they were here.

Holding a Tax Court special trial judge to be an "inferior Officer" also comports with the venerable definition of "officer" formulated by Chief Justice Marshall for purposes of construing the Appointments Clause in *United States* v. *Maurice*, 26 Fed.Cas. 1211, 1214 (No.15,747) (1823): an

officer is one who performs duties that are continuing and that are defined by laws or rules prescribed by government rather than by contract. The term "embraces the ideas of tenure, duration, emolument, and duties, and that the latter were continuing and permanent, not occasional or temporary." *United States* v. *Germaine*, 99 U.S. (9 Otto) 508, 511-12 (1879). *See also Auffmordt* v. *Hedden*, 137 U.S. 310, 326-27 (1890). The office of special trial judge is created by statute, it is filled by "appointment," and the duties appurtenant thereto are spelled out in statute and Tax Court rules. *See* 26 U.S.C. § 7443A (A100); Tax Court Rules 180-83.

Special trial judges in the Tax Court are at least as much "officers" as federal magistrates in the Article III District Courts, who are deemed inferior officers whose appointment (by the Article III judiciary) must comport with the Appointments Clause. *Pacemaker Diagnostic Clinic* v. *Instromedix*, 725 F.2d 537, 545 (9th Cir.) (*en banc*), *cert. denied*, 469 U.S. 824 (1984). Indeed, special trial judges enjoy greater power under federal law than do magistrates, since their trial rulings are unreviewed and even their ultimate findings and opinions are presumed correct. In contrast, magistrates may preside over and enter final judgment in a civil trial only with the consent of the parties, 28 U.S.C. § 636(c)(1), and their rulings on dispositive motions, their findings of fact and their conclusions of law are all subject to *de novo* review if any party files objections. *See, e.g.*, *LoConte* v. *Dugger*, 847 F.2d 745, 750 (11th Cir.) (reviewing district judge must actually read transcript or listen to tape recordings of testimony magistrate heard), *cert. denied*, 109 S.Ct. 397 (1988). Accordingly, a special trial judge is an "inferior Officer."[26]

[26] Indeed, under this Court's decision in *Morrison* v. *Olson*, 487 U.S. 654, 671-73 (1988), it is even arguable that a special trial judge is a "principal" rather than an "inferior" officer. Under the expansive reading of § 7443A adopted below, a special trial judge's "duties" are not "limited," *id.* at 671 (he may exercise all the powers of a Tax Court judge both before and during trial); his "jurisdiction" is not "limited," *id.* at 672 (he can preside over and decide *any* case, subject only to "clearly erroneous" review); and his "office" is not "limited in tenure," *id.* (he is a full-time adjudicative officer, not someone designated on an *ad hoc*, temporary basis to "accomplish a single task, and when that task is over the office is terminated," *id.*). If a special trial judge is a principal rather than an inferior officer, reversal of the judgment below is mandated, because all principal officers must be appointed by the President with the advice and consent of the Senate. *See* Art. II, § 2, cl.2.

B. The Chief Judge Of The Tax Court Is Not A "Head Of Department" Within The Meaning Of The Appointments Clause.

Treating the Article I Tax Court as a "Department" within the meaning of the Appointments Clause, and its Chief Judge as the "Head" of that "Department," would both defy the plain meaning of the Constitution's text and fly in the face of Congress' decision to transform the Tax Court from an executive agency into an Article I legislative court. The only way to reach such an unnatural conclusion would be by a simplistic and failacious process of elimination: since the Tax Court is not part of the Legislative Branch, nor a "Court of Law," see Part II.C., *infra*, it must be a "Department" in the Executive Branch. Any such argument must be rejected in light of the legislative history of the Tax Court and a hundred years of consistent judicial interpretation of the Appointments Clause.

1. History of the Tax Court.

Classifying the Tax Court as an Executive "Department" would certainly come as a surprise to Congress, which enacted legislation in 1969 with the express purpose of "making the Tax Court an Article I court rather than an executive agency." S.Rep. No 91-552 at 303; DuBroff at 213. See page 2 *supra*. Congress deemed it "anomalous to continue to classify" the Tax Court with executive agencies, S.Rep. No. 91-552 at 302, considered it burdensome and inappropriate to have the Tax Court subjected to the strictures of the Administrative Procedure Act, *see* Dubroff at 191-92, 213, 215 & n.351, and questioned whether it was "appropriate for one executive

agency [the pre-1969 Tax Court] to be sitting in judgment on the determinations of another executive agency [the IRS]." *Id.* Surely a federal court may not override Congress' considered judgment and redesignate as an Executive "Department" an entity that Congress explicitly distanced from Executive control and reconstituted as an Article I legislative court.[27]

2. Interpretation of the Constitution's Text.

Even it were assumed arguendo that the Tax Court must be located within the Executive Branch, it would not follow that the Tax Court was an Executive Department within the meaning of the Appointments Clause. The Appointments Clause limits the vesting of appointment power within that Branch to the "Heads of Departments," and not every institutional entity within the Executive Branch is a Department.

The Departments of the United States Government are identified by statute, and the list does not include the Tax Court.[28] This Court has consistently held for more than a century that the term "Department" refers only to those "'part[s] or divi-

[27] In *Germaine*, this Court noted that the phrase "Head of Department" in the Appointments Clause must be read in conjunction with the Opinion Clause of Art.II, § 2, cl.1: the President "may require the Opinion, in writing, of the principal Officer in each of the executive Departments." 99 U.S. at 511. Thus if the Chief Judge of the Tax Court were the "Head" of a Department, he could be compelled to provide advisory opinions to and perform other analytical and investigative tasks for the President. Yet one of the reasons for transforming the Tax Court into an Article I tribunal in 1969 was to eliminate the need for that tribunal to respond to Executive inquiries pertaining to executive supervisory or budgetary authorities, a task that was cumbersome and often irrelevant to the Tax Court's adjudicative duties. *See* Dubroff at 190 & n.177.

[28] Under 5 U.S.C. § 101, the Executive "Department[s]" are: State, Treasury, Defense, Justice, Interior, Agriculture, Commerce, Labor, Health and Human Services, Housing and Urban Development, Transportation, Energy, Education and Veterans Affairs. Significantly, three of these Departments — Energy, Education and Veterans Affairs — have been added by Congress since 1969, the year Congress changed the status of the Tax Court to an Article I court. Had Congress meant to establish the Tax Court as a Department rather than an Article I legislative court, it surely would have amended 5 U.S.C. § 101, as it has every other time it has added a new Department to the executive branch.

sion[s] of executive government, as the Department of State, or of the Treasury,'" expressly "creat[ed]" and "giv[en] . . . the name of a department" by Congress. *United States* v. *Germaine*, 99 U.S. 508, 510-11 (1879). *See also Burnap* v. *United States*, 252 U.S. 512, 515 (1920) (Brandeis, J.) ("The term head of a Department means . . . the Secretary in charge of a great division of the executive branch of the Government, like the State, Treasury, and War, who is a member of the Cabinet."). Accordingly, the term "Head of Department" means "members of [the President's] cabinet," not mere "commissioners and bureau officers." *Germaine*, 99 U.S. at 511.

This reading of the term "Heads of Departments" in the Appointments Clause is buttressed by the understanding of that term as it appears in other provisions of the Constitution.[29] For example, in *Germaine* this Court noted that the phrase "Head of Department" in the Appointments Clause has the same meaning as the reference to the "principal Officer in each of the executive Departments" in the Opinion Clause of Art.II, § 2, cl.1. 99 U.S. at 511. See note 27 *supra*. This latter cognate phrase also appears in Section 4 of the 25th Amendment, which empowers the Vice President, together with a majority of the "principal officers of the executive departments," to unseat the President when they deem him incapacitated.[30] The hearings on the 25th Amendment make clear that the term "Department" denotes only the great, Cabinet-level executive entities: "[O]nly officials of Cabinet rank should participate in the decision as to whether presidential inability

[29] The Constitution repeats many legal terms of art in its different provisions, and they are naturally understood to mean the same things each time. For example, the "Bill of Attainder," "ex post facto Law" and "Title of Nobility" mentioned in Art. I, § 9 are the same as the Bill, Law and Title denoted by those same terms in Art. I, § 10.

[30] "Whenever the Vice President and a majority of either the principal officers of the executive departments or of such other body as Congress may by law provide, transmit . . . their written declaration that the President is unable to discharge the powers and duties of his office, the Vice President shall immediately assume the powers and duties of the office as Acting President." 25th Amendment, § 4.

exists . . . The intent . . . is that the presidential appointees who direct the 10 executive departments named in 5 U.S.C. § 1, or any executive department established in the future, generally considered to comprise the President's Cabinet, would participate . . . in determining inability." H.R.Rep. No. 203, 89th Cong., 1st Sess. 3 (1965). *See also id.* at 13; S.Rep. No. 66, 89th Cong., 1st Sess. 2-3, 13 (1965). Whether inscribed with a quill pen in 1787 or a typewriter in 1965, the Constitution's references to Executive "Departments" have consistently been limited to the great, Cabinet-level organs of government.

3. The Framers' Understanding of "Department."

This Court's settled interpretation of the Appointments Clause is entirely consistent with the history of that clause and with the Framers' intent. The Framers themselves interpreted "Heads of Departments" just as narrowly as this Court has for over a hundred years, and that is precisely why James Madison complained that the clause "did not go far enough" because it did *not* allow appointment power to be vested in "Superior Officers" in the Executive Branch who were not "Heads of Departments." See pages 25-26 *supra*. Yet this was one battle that Madison lost; this provision of the Appointments Clause was unanimously approved despite his objection.

The government thus asks this Court to rewrite the Appointments Clause to permit the very diffusion of appointment power that the Framers intended to forbid. If this Court were to disregard the language of the Clause, the history of its adoption, the Framers' understanding of it, and a century of consistent judicial interpretation, the Court would launch the appointment power down a very treacherous slope. For if all entities in government not located within the Legislative or Judicial Branches can be vested with appointment power as "Departments," then there is no limiting principle left to the Appointments Clause. The class of officeholders who could be vested

with the power to appoint inferior officers of the United States would then be expanded to the outer limits of the Capital Beltway. If such power can be vested in the Tax Court on the theory that it, too, is an Executive "Department," then that power can be conferred on every "commission," "administration," "authority," "agency," "panel," "task force," "board," "bureau" and "legislative court" in the federal government.

C. The Tax Court Is Not A "Court Of Law" Within The Meaning Of The Appointments Clause.

The alternative proposition that the Tax Court is a "Court of Law" should likewise be rejected. The fact that the Tax Court may be an Article I court does not *ipso facto* make it a "Court of Law" within the meaning of the Appointments Clause. That clause must be read in the context of the entire Constitution. As the Solicitor General formally conceded in his brief in the related *Samuels, Kramer* case, an Article I court cannot be a "Court of Law" for Appointments Clause purposes, because the Framers used the term "the Courts of Law" in the Clause to refer to those courts created and existing under Article III as part of the Judicial Branch.

1. The Constitution's Text.

Understanding the Framers to have meant "Courts" in the Appointments Clause to denote the same institutions they described as "Courts" in Art. III, § 1, is not only the most natural reading of the Constitution's text, but also the reading suggested by this Court. Just as our understanding of "Department" is informed by how that term is used elsewhere in the Constitution, see Part II.B. *supra*, so the term "Courts of Law" is illuminated by cognate provisions of the Constitution. In *Buckley* v. *Valeo*, this Court held that the Appointments Clause must be read in light of Article III's grant of judicial power. After reciting the Constitution's three grants of Legislative, Executive and Judicial power, including Art. III, § 1's declara-

tion that "[t]he judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish," the Court reasoned that "[i]t is in the context of these cognate provisions of the document that we must examine the language of Art. II, § 2, cl. 2." 424 U.S. at 124. Article III courts are the only "Courts" mentioned by name in the Constitution, and they must be the same as the "Courts of Law" referred to in the Appointments Clause.

When this Court restated the command of the Appointments Clause in *Buckley*, the terms it chose were significant: "Inferior officers Congress may allow to be appointed by the President alone, by the heads of departments, or by *the Judiciary*." 424 U.S. at 132 (emphasis added). *See also Morrison* v. *Olson*, 487 U.S. at 670 (quoting *Buckley*). In the context of the Federal Constitution generally, and in particular with respect to the Appointments Clause, the term "Judiciary" has always been understood to refer exclusively to those judges appointed in accord with Article III.[31] There is no reason to depart from this precedent and to reinterpret "Court of Law" to mean any adjudicative tribunal in the federal government.

2. The Specialized Nature of the Tax Court.

Although the Tax Court is undeniably an adjudicative forum, not all "courts" are created equal under the Appointments Clause. Even if this Court were writing on a blank slate, there are reasons not to deem "Court of Law" to include Article I legislative tribunals. The Tax Court is not a "Court of Law" —

[31] *See, e.g., Buckley*, 424 U.S. at 132; *Marathon Pipe Line*, 458 U.S. at 70 n.25. *See also Buckley*, 424 U.S. at 128 (Appointments Clause allows power to be vested in "co-equal Judicial and Executive Branches"); *Morrison* v. *Olson*, 487 U.S. at 677 (appointment power can be vested in "Executive Branch" and "Judicial Branch"); *id.* at 678-79 ("Courts of Law" discussed exclusively in terms of Article III courts); *In the Matter of Koerner*, 800 F.2d 1358, 1367 (5th Cir. 1986) (discussing Appointment Clause in terms of "executive or judicial branches").

"[i]t has no jurisdiction to exercise the broad common law concept of 'judicial power' invested in courts of general jurisdiction by Article III of the Constitution." *Burns, Stix Friedman & Co.* v. *Comm'r*, 57 T.C. 392, 396 (1971).[32] It is rather a "public rights" tribunal that adjudicates matters "arising 'between the Government and persons subject to its authority in connection with the performance of the constitutional functions of the executive or legislative departments.'" *Marathon*, 458 U.S. at 67-68 (quoting *Crowell* v. *Benson*, 285 U.S. 22, 50 (1932)). This Court's consistent distinction between "public rights" tribunals "'with special competence in the relevant field'" and "'a federal court of law'" of general jurisdiction, *Granfinanciera, S.A.* v. *Nordberg*, 109 S.Ct. 2782, 2795 & n.9 (1989), buttresses the proposition that the Tax Court is not a "Court of Law" within the meaning of the Appointments Clause.[33]

[32] "It does not follow from the fact that the Tax Court is now an Article I 'legislative court' that it possesses . . . the full judicial power, extending to 'all cases, in law and equity,' that is vested in 'constitutional courts' created by Congress under Article III." *Continental Equities, Inc.* v. *Comm'r*, 551 F.2d 74, 84 (5th Cir. 1977). *See also Lasky* v. *Comm'r*, 235 F.2d 97, 99 (9th Cir. 1956) (rejecting argument that Tax Court "is 'like other courts' and hence as a *court* has . . . '*inherent* power[s]'") (emphasis in original), *aff'd per curiam*, 352 U.S. 1027 (1957); *West* v. *Comm'r*, 150 F.2d 723, 727 (5th Cir.) (Tax Court "differs from the old Court of the Exchequer in England in that the latter was a judicial court of law and equity with exclusive jurisdiction in fiscal matters."), *cert. denied*, 326 U.S. 795 (1945).

Indeed, it would be strange to consider the Tax Court a "Court of Law" since Congress has forbidden the Tax Court from requiring that those who practice before it be admitted to the practice of law. *See* 26 U.S.C. § 7452 ("No qualified person shall be denied admission to practice before the Tax Court because of his failure to be a member of any profession or calling.").

[33] Any comparison of specialized federal legislative courts to the courts established in the territories and the District of Columbia, and the power those courts have sometimes been given to appoint their own clerks, would be wholly inapposite. For it has long been settled that the Constitution does not require that the separation, checks and balances mandated at the federal level, "where laws of national applicability and affairs of national concern are at stake," be replicated at the level of territorial and District of Columbia governments. *Palmore* v. *United States*, 411 U.S. 389, 407-08 (1973) (federal separation of powers "give[s] way to accommodate plenary grants of power to Congress to legislate with respect to specialized areas"). As Chief Justice Marshall first

3. The Tax Court's Relationship with Congress.

Article I courts also differ from Article III courts in their relationship with Congress. Perhaps the most important Appointments Clause imperative is that the power to appoint federal officers be kept out of legislative hands. *See Buckley* v. *Valeo*, 424 U.S at 129-31; *Morrison* v. *Olson*, 487 U.S. at 685-86. Just as the President and the Heads of Departments may fend off congressional overreaching by virtue of their independent political constituency and the checks on legislative power that the Executive enjoys under the Constitution, so the tenure and salary protections of Article III provide the Judiciary with the necessary independence from the Legislative Branch.

No such guarantees exist with respect to the Article I Tax Court, toward which Congress often displays an almost proprietary relationship. Despite its title and adjudicative functions, the Tax Court is considered by many to be "a legislative body performing judicial functions," DuBroff at 215, *cf. Bowsher* v. *Synar*, 478 U.S. 714, 730-31 (1986) (relying on academic study of GAO to conclude it was subject to congressional influence); or "an independent judicial body in the legislative branch," Office of the Federal Register, Nat'l Archives and Records Admin., *The United States Government Manual* 76 (1989/1990) (official government manual describing Tax Court's status since 1969). *Cf. Bowsher* v. *Synar*, 478 U.S. at 744 & n.6 (Stevens, J., concurring in the judgment) (relying on statutes and reports describing GAO as part of legislative branch); *see also id.* at 730-31 (opinion of the Court) (same).

explained in *Sere and Laralde* v. *Pitot*, 10 U.S. (6 Cranch) 332 (1810), irrespective of the Constitution, Congress may give a territorial government "a legislative, an executive, and a judiciary with such powers as it has been their will to assign those departments respectively." *Id.* at 337 (emphasis added). *See also Glidden* v. *Zdanok*, 370 U.S. 530, 545-46 (1962) ("the freedom of the territories to dispense with protections deemed inherent in a separation of governmental powers was . . . fully recognized"); *O'Donoghue* v. *United States*, 289 U.S. 516, 545-48 (1933) (courts in District of Columbia may mingle Art. III power with nonjudicial administrative and executive functions); *American Ins. Co.* v. *Canter*, 26 U.S. (1 Pet.) 511, 546 (1828) (Art. III separation of powers "limitation does not extend to the territories").

There is no limiting principle to the argument that practical necessity or administrative convenience requires that the Tax Court be allowed to appoint special trial judges, as the Tax Court's holding in the *Samuels, Kramer* case makes plain. The Tax Court there held that Congress may vest federal appointment power in any "lawfully created government body" *even if* that body does "not fit within the terms 'Heads of Departments' or 'Courts of Law.'" (A86). Such a notion simply cannot be reconciled with the Constitution. If the term "Courts of Law" is expanded to embrace the Tax Court, then Congress will be free to vest appointment power in every legislative court or other adjudicatory body in the federal government.

D. Reading The Appointments Clause To Preclude Tax Court Appointment Of Special Trial Judges Will Cause The Federal Government At Most Minimal Disruption.

Even if Tax Court appointment of special trial judges were regarded as practical, that would not make it constitutional. "There is no support in the Constitution or decisions of this Court for the proposition that the cumbersomeness and delays often encountered in complying with explicit constitutional standards may be avoided." *INS* v. *Chadha*, 462 U.S. 919, 963 (1983) (striking down, for violation of the Presentment and Bicamerality requirements of Art. I, hundreds of one-house legislative veto statutes despite half a century of accepted use). Fortunately, no choice between practicality and the Constitution is posed here, for invalidating Tax Court appointment of special trial judges would cause little inconvenience for the federal government.

First, all that need happen in this case is a remand for trial before a regular tax court judge. Moreover, there need be no concern that the relief petitioners seek might disable the Tax Court generally, for the court will continue to function and the

constitutional flaw could be easily remedied. Upon invalidation of the current method of appointing special trial judges, Congress could simply expand the Tax Court to include additional judges to be appointed in accord with the Appointments Clause as are the current Tax Court judges.[34] This was the route Congress chose when it changed the Claims Court from an Article III court to an Article I tribunal in 1982.[35] Alternatively, the special trial judges could be appointed as inferior officers by "the President alone." Art. II, § 2, cl.2. Either resolution would be practicable and, more importantly, consistent with the narrow scope and most natural reading of the Appointments Clause.

Second, confining appointment of inferior officers to the "Heads of Departments" and the "Courts of Law" as required by the Appointments Clause would pose no significant disruption to the way in which seemingly similar positions elsewhere in the federal government are filled, because virtually all other adjudicatory officers and agents in the federal government are different from Tax Court special trial judges in significant ways.

The appointment power of the Article III Judiciary (who are undoubtedly "Courts of Law") is unquestioned; so, for example, federal magistrates and bankruptcy judges who serve as adjuncts to Article III courts are completely unaffected by this case. See 28 U.S.C. §§ 152, 631(a). The appointment power that the Heads of the Executive Departments may wield pursuant to congressional grant is likewise unquestioned.

[34] Even this step may not be necessary, because the inventory of pending Tax Court cases declined 40% between 1986 and 1990. See Interview with Arthur L. Nims, III, Chief Judge, U.S. Tax Court, 10 A.B.A. Section of Taxation Newsletter, No. 2, 34-37 (Winter 1991). The Tax Court expects that its docket will stabilize at this new, lower level. *Id.*

[35] *See* Pub.L. 97-164, Title I, § 121(b), 96 Stat. 34 (1982). The offices of the fifteen Claims Court commissioners (appointed by the Claims Court when it was an Article III tribunal) were eliminated. But the Court itself was expanded from seven to sixteen judges to compensate for the increased workload. *See also* 28 U.S.C. § 171.

Administrative law judges ("ALJs") who serve in Executive Branch agencies and independent commissions[36] are likewise unaffected by the outcome of this case, for they are hired through the competitive civil service and are expressly and aptly designated "employees," rather than inferior officers, by the relevant legislation and rules.[37] Other commission and agency staff members are likewise employees, such as, for example, the "officers, attorneys, examiners, and other experts" whom the Securities and Exchange Commission is "authorized to appoint and fix the compensation of," often "subject to the civil-service laws." 15 U.S.C. § 78d(b).[38] Such personnel, unlike special trial judges, are not "officers" within the meaning of the Appointments Clause because their offices, positions, duties, functions and compensation are left up to the agencies (or the Office of Personnel Management) rather than "established by law." See Part II.A. *supra.*[39]

[36] *See, e.g., CFTC* v. *Schor*, 478 U.S. 833, 838 (1986) (proceedings before CFTC adjudicated by ALJs).

[37] The Administrative Procedure Act expressly denominates the ALJs "presiding *employees*." 5 U.S.C. §§ 554(d), 556(b) & (c), 557(b) (emphasis added). See also 5 C.F.R. § 930.201(b) (ALJ is a competitive civil service position). ALJs take competitive civil service exams, 5 U.S.C. § 1104(a)(2); are paid according to civil service pay scales, 5 U.S.C. §§ 5335(a)(B), 5372; and are hired, fired, and transferred among agencies pursuant not to the whims of the agency and commission heads but to the regulations and authority of the Office of Personnel Management, 5 U.S.C. §§ 1305, 3344, 7521; 5 C.F.R. § 930.203a(a).

[38] The vast expansion in the size of the federal bureaucracy since the Republic's birth has come almost entirely in the form of a proliferation of inferior executive officers appointed by the President or his Cabinet Secretaries and a swelling of the "roster of minor employees." *United States* v. *Mitchell*, 89 F.2d 805, 808 (D.C.Cir. 1937). This case does not affect the selection of any of these officers or workers, for the latter are not governed by the Appointments Clause while the former are appointed consistent with it.

[39] *See, e.g., United States* v. *Mitchell*, 89 F.2d at 808 (FCC attorneys are "employees of government who are not 'officers,' a class of employees not intended to be and not required to be appointed by the President or by a Head of Department"). *Cf. United States* v. *Maurice*, 26 Fed.Cas. at 1214-15 ("officers" occupy "offices" specifically created by Congress; a statute directing Secretary of War to prepare regulations defining duties and powers of enumerated personnel "cannot be construed to extend to the establishment of offices").

The only officeholders other than special trial judges whose appointment would be thrown into doubt by a reversal in this case are statutorily authorized and defined officers appointed by other Article I tribunals such as the Claims Court. As to this category of officers, which in any event is quite limited in number, the Executive Branch itself has already identified the constitutional problem. President Bush himself declared in a recent signing statement that the Appointments Clause had been violated when Congress authorized the Claims Court to appoint special masters to hear and effectively decide claims arising under the National Vaccine Injury Compensation Program. 42 U.S.C. §§ 300aa-11, 300aa-12(a). The office, tenure, compensation, jurisdiction and duties of these special masters — like those of Tax Court special trial judges — are carefully defined by statute. *See* §§ 300aa12(c) & (d). The special masters' proposed findings of fact and conclusions of law must be presumed correct by the Claims Court — as Rule 183(c) requires with respect to special trial judge factual findings — and may be set aside only if "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." § 300aa-12(e)(2)(B).

The vaccine special masters, like Tax Court special trial judges, are inferior officers of the United States whose method of appointment violates Article II, § 2 because the Claims Court, like the Tax Court, is neither a "Department" nor a "Court of Law." As the President himself noted upon signing the bill creating the vaccine masters: the bill "vest[s] significant authority pursuant to the laws of the United States in persons whose appointment and removal are inconsistent with the requirements of Article II . . . ."[40] The government has admitted that its analysis of the Appointments Clause in the Fifth Circuit below cannot be reconciled with this formal statement by the President that Article I courts cannot wield appointment power under Art. II, § 2, cl.2. (*See* A102-03).

[40] Statement of the President on Signing the Omnibus Budget Reconciliation Act of 1989, 25 Weekly Comp. of Pres. Docs. 1970-1 (Dec. 19, 1989). Pertinent portions of the statement are reprinted in Appendix G. (A103).

Interpreting the Appointments Clause to bar Article I courts from appointing inferior officers would thus have only the slightest impact on the federal government's operations. In stark contrast, the reinterpretation of the Appointments Clause urged by the government and amicus would allow the diffusion of appointment power throughout the breadth and depth of the federal bureaucracy, to the point where just about the only federal officers who could not be vested with power to appoint inferior officers would be the Members of Congress.

III. "CONSENT" TO THE ASSIGNMENT TO THE SPECIAL TRIAL JUDGE BELOW CANNOT AND DID NOT WAIVE ANY CHALLENGE TO THE APPOINTMENT OF THAT JUDGE UNDER THE APPOINTMENTS CLAUSE.

Although the Appointments Clause issue was briefed and argued by both parties below, the Fifth Circuit declined to reach it, holding that, "[b]y consenting to the assignment of their case at the time it was made, the Taxpayers waived this objection." (A8 n.9). This ruling cannot be reconciled with the Fifth Circuit's simultaneous decision to decide petitioners' objection to the statutory authority of special trial judges, which is unchallenged on this appeal. If a mere statutory objection to the assignment of a special trial judge to this case "may be raised for the first time on appeal" because it "is, in essence, an attack on the subject matter jurisdiction of the special trial judge" (A7), then "*[a] fortiori* is this so when the challenge is based on nonfrivolous constitutional grounds," *Glidden* v. *Zdanok*, 370 U.S. 530, 536 (1962), and the objection goes to the authority of the Tax Court even to appoint such an officer. No meaningful distinction can be drawn between proceedings void for lack of jurisdiction and those void for lack of a properly appointed adjudicator. As this Court explained last year in *Burnham* v. *Superior Court*, 110 S.Ct. 2105 (1990):

> The proposition that the judgment of a court lacking jurisdiction is void traces back to the English Year Books . . . [and was] [t]raditionally . . . embodied in the phrase *coram non judice*, "before a person not a judge" — meaning, in effect, that the proceeding in question was not a judicial proceeding because lawful judicial authority was not present, and could therefore not yield a judgment.

Id. at 2109 (emphasis in original).[41] Even if such a distinction could be drawn, the petitioners' consent to the assignment to a special trial judge below should not bar this Court from reaching the merits of petitioners' constitutional objection.

A. This Court May Reach And Decide These Constitutional Objections Even Though They Were Not Raised Or Considered In The Tax Court Below.

As Justice Harlan wrote in *Glidden* v. *Zdanok*, 370 U.S. 530 (1962), even "the disruption to sound appellate process entailed by entertaining objections not raised below" is "plainly insufficient to overcome the strong interest of the federal judiciary in maintaining the constitutional plan of separation of powers." *Id.* at 536.[42] In *Glidden* this Court expressly in-

[41] Compare *Lamar* v. *United States*, 241 U.S. 103, 117-18 (1916), where the argument that this Court considered, even though it was waived below and was raised, for the first time, in a supplemental brief in this Court, was that the trial court had no jurisdiction — indeed, that the trial court did not even properly *exist* — because the judge had been judicially assigned from another circuit in "usurp[ation] [of] the power of appointment and confirmation vested by the Constitution in the President and Senate."

[42] When the law or regime at issue "is not merely technical but embodies a strong policy concerning the proper administration of judicial business, this Court has treated the alleged defect as 'jurisdictional' and agreed to consider it on direct review even though not raised at the earliest practicable opportunity. *A fortiori* is this so when the challenge is based upon nonfrivolous constitutional grounds." *Glidden*, 370 U.S. at 535-36. The constitutional legitimacy of Tax Court appointment of its special trial judges certainly concerns the "proper administration" of the Tax Court's "judicial business," and petitioners' Appointments Clause argument is anything but "[ ]frivolous." Even more important,

cluded Appointments Clause objections to judicial officers in the category of structural constitutional objections that should be considered on appeal regardless of whether they were ruled upon below:

> [I]n *Lamar* v. *United States*, 241 U.S. 103, 117-18, the claim that an intercircuit assignment . . . usurped the presidential appointing power under Art. II, § 2, was heard here and determined upon its merits, despite the fact that it had not been raised in the District Court or in the Court of Appeals or even in this Court until the filing of a supplemental brief upon a second request for review.

370 U.S. at 536. *See also id.* at 539-40 (considering Appointments Clause argument not raised until hearing in this Court). The government has already conceded that *Glidden* and *Lamar* "stand for the proposition that the Court has subject matter jurisdiction to reach the merits of a constitutional claim not raised by the parties below." Opp.Br. at 17 n.13. In this case the Appointments Clause issue was raised below and briefed by both parties in the Court of Appeals. This issue has cast doubt on the legitimacy of Tax Court assignments to special trial judges and spawned division within the Executive Branch. This Court has already granted certiorari and the issue has been fully ventilated by the parties. If the statutory issue does not resolve the case in petitioners' favor, the Court should now decide the second question presented.

B. Challenges Based On The Appointments Clause Are Not Waivable By The Consent of the Parties, For That Clause Protects The Constitution's Structural Separation Of Powers, Not The Parties' Personal Rights.

The Fifth Circuit's waiver ruling is in any event plainly incorrect under this Court's decisions holding that an argument

petitioners' "earliest practicable opportunity" to press their constitutional objection was in the Fifth Circuit, for not until the Tax Court had adopted verbatim Special Trial Judge Powell's opinion did it first become apparent that petitioners would be denied the *de novo* review they anticipated when they accepted the mid-trial reassignment to Judge Powell.

premised on the Constitution's structural separation of powers is not a matter of personal rights and therefore is not waivable. A constitutional provision safeguarding a "personal right," such as "Article III's guarantee of an impartial and independent federal adjudication[,] is subject to waiver, just as are other personal constitutional rights that dictate the procedures by which civil and criminal matters must be tried." *CFTC* v. *Schor*, 478 U.S. 833, 848-49 (1986). But if a provision "also serves as 'an inseparable element of the constitutional system of checks and balances,'" it cannot be waived. *Id.* at 850. *See also Pacemaker Diagnostic Clinic* v. *Instromedix*, 725 F.2d at 543-44 (per Kennedy, J.) ("The component of the separation of powers rule that protects the integrity of the constitutional structure, as distinct from the component that protects the rights of the litigants, cannot be waived by the parties."). When a

> structural principle is implicated in a given case, the parties cannot by consent cure the constitutional difficulty for the same reason that the parties by consent cannot confer on federal courts subject matter jurisdiction beyond the limits imposed by Article III, § 2. . . . [N]otions of consent and waiver cannot be dispositive because the limitations serve institutional interests that the parties cannot be expected to protect.

CFTC v. *Schor*, 478 U.S. at 850-51.[43] Indeed, such structural objections will be heard and decided even where the objecting

[43] Accordingly, this Court reached and decided the structural Article III issue in *Schor* even though "Schor indisputably waived any right he may have possessed" to an Article III tribunal by invoking the jurisdiction of the CFTC, seeking to have the suit in the alternative Art. III forum dismissed, and "expressly demand[ing]" that the case — including the counterclaim at issue — proceed before the CFTC. 478 U.S. at 849. *A fortiori*, the Court should decide the constitutional separation of powers issue presented here, where the petitioner consented to trial before a special trial judge under duress in mid-trial when the presiding Tax Court judge fell ill. See pages 49-50, *infra*.

party deliberately delayed raising the issue until the case was decided against him.[44]

No meaningful distinction can be drawn between the structural principle at issue here and the one considered by this Court in *Schor*.[45] There can be no hierarchy among separation of powers principles, in which some are fundamental and nonwaivable while the judicial vindication of others may be relegated to the vagaries of individual litigation strategies. If anything, the grounds for nonwaivability are even clearer and more straightforward here than in *Schor* or *Pacemaker*, since the Appointments Clause is purely structural and, unlike the Article III principles parsed into their respective personal and structural components in those cases, has no "personal rights" element.

The government nevertheless attempted in its Brief in Opposition to characterize the Appointments Clause as some sort of second-class component of constitutional architecture whose protection the federal courts can leave to the parties before it, subject to the usual rules of waiver. The government's premise is that, unlike Article III or any other structural provision of the Constitution, "the Appointments Clause embodies an interest that at least one of the parties to every tax dispute (the United States) can be expected to protect" vigorously, because

[44] *Schor* was such a case. Schor "was content to have the entire dispute settled in the forum he had selected until the ALJ ruled against him on all counts; it was only after the ALJ rendered a decision to which he objected that Schor raised any challenge to the CFTC's consideration of [his opponent's] counterclaim." 478 U.S. at 849. *See Glidden* v. *Zdanok*, 370 U.S. at 535-36 (usual rule "preventing litigants from abiding the outcome of a lawsuit and then overturning it if adverse upon a technicality of which they were previously aware" does "not obtain" when the defect is "jurisdictional" or "is based upon nonfrivolous constitutional grounds").

[45] This case similarly parallels the circumstances in *Pacemaker Diagnostic Clinic* v. *Instromedix*, where a party challenged a magistrate's power to preside over a civil trial and enter the final judgment, despite that party's formal consent to the procedure. In reaching the merits of the constitutional challenge, Judge (now Justice) Kennedy wrote for the *en banc* court that "[s]tatutes or governmental actions which violate the separation of powers doctrine in its systemic aspect should be invalidated, as a general rule, despite waiver by affected private parties." 725 F.2d at 544.

the "structural interests protected by the Appointments Clause are . . . those of the President and the Executive Branch itself." Opp.Br. 19. This Court's precedents, however, explode any such proposition.[46]

For example, the Appointments Clause claims resolved by this Court in *Lamar* v. *United States* and *Morrison* v. *Olson* — that particular appointment mechanisms usurped the Executive appointment power — were raised, as here, by the private parties, not by the government party. In each case, the government party was more interested in preserving the fruits or promises of a particular criminal prosecution than in safeguarding the Constitution's structural integrity.

When it comes to the separation of powers, foxes cannot be trusted to guard henhouses. This Court has never relied exclusively upon the other two branches of government to look after the Constitution's structural blueprints, even when the only apparent injury was to the prerogatives of one of those branches. Both Congress and the Executive have all too often been willing to sell their birthright for a mess of potage — to violate the separation of powers and relinquish certain prerogatives or duties in order to meet some felt necessity or to deal with exigent circumstances.[47] Thus the Executive Branch cannot, any more than any other party, be relied upon to protect

[46] Moreover, even if the branches of the federal government were allowed to relinquish their powers, the appointment power is not a purely Executive prerogative. With respect to inferior officers, appointment power may be lodged by Congress in either the President and his Department Heads or in the Courts of Law. Even if the government's "self-interest" model of separation-of-powers litigation were valid, the Solicitor General has no authority to relinquish or dilute the Appointments Clause prerogatives of the Article III judiciary.

[47] *See, e.g.*, *INS* v. *Chadha* (striking down one-house legislative veto provision agreed to by President and Congress); *Bowsher* v. *Synar* (invoking Appointments Clause to strike down Gramm-Rudman budget-balancing legislation agreed to by President and Congress); *Buckley* v. *Valeo* (invoking Appointments Clause to strike down Federal Election Campaign Act over the objections of the Executive and Legislative Branches that had collaborated on the law). *Cf.* *Zschernig* v. *Miller*, 389 U.S. 429, 443 (1968) (Stewart, J., concurring) (State Department cannot permit local probate officials to conduct American foreign policy, for the Constitution confers that duty on the Executive Branch, even if a particular President and Secretary of State are willing to relinquish it to others).

the "institutional interests" served by the Appointments Clause and the Constitution's other structural provisions. *CFTC* v. *Schor*, 478 U.S. at 851. Indeed, the Executive Branch has spoken with quite different voices in the course of this very case: while the President himself took a stand against vesting appointment power in Article I courts when this case was being briefed and argued below, the Justice Department now argues that that power may be dispersed to an ever-widening circle of federal officials.

C. In Any Event, There Was No Free And Voluntary Consent Below To Effectively Final Decision By A Special Trial Judge.

Even if this Court were to deem Appointments Clause objections to be "personal" rather than structural, or to decide that some "second-class" structural objections were sometimes waivable, no such waiver should be found here. For in the circumstances of this case, petitioners cannot be said to have voluntarily relinquished their rights to trial before a constitutionally appointed officer.

1. The Statutes and Rules Governing Tax Court Procedure in (b)(4) Cases Neither Require Nor Ensure Consent.

The Tax Court has no procedure whatever even for requiring taxpayer consent to the jurisdiction of a special trial judge exercised here, much less any safeguards for ensuring that consent be knowing and voluntary. Under § 7443A(b)(4), the "chief judge may assign . . . any other proceeding which the chief judge may designate to be heard by the special trial judges of the court," regardless of the taxpayer's wishes. Subsection (b)(4)'s silence as to taxpayer consent can hardly be dismissed as an oversight, for Congress took pains to specify those instances in which taxpayer consent was required. For example, small tax proceedings under subsection (b)(2) may

be assigned to a special trial judge only "at the option of the taxpayer." § 7463(a).

In other statutory regimes governing the use of adjunct adjudicators, Congress has gone to great lengths to specify statutory mechanisms for requiring litigant consent and ensuring that it be fully knowing and voluntary. When the Federal Magistrates Act permits assignment of a case to a magistrate for disposition, it not only requires affirmative consent of the litigant prior to such assignment, but also expressly bars both the district court and the magistrate from attempting to induce such consent and mandates that rules of court "shall include procedures to protect the voluntariness of the parties' consent." 28 U.S.C. § 636(c)(1)&(2). Moreover, a litigant dissatisfied with the magistrate's decision of a dispositive matter is entitled to a *de novo* review by the district court. *Id.* at § 636(b)(1).

Such meticulous statutory safeguards are wholly absent from the statute and rules governing assignment of (b)(4) proceedings to the Tax Court's special trial judges. Where such protection is wholly lacking in the statutory regime, an *ad hoc* "consent" should not lightly be presumed to be free and voluntary, much less treated as a waiver of important constitutional rights.[48]

[48] Petitioners cannot be said to have voluntarily relinquished their rights to trial before a constitutionally appointed judicial officer merely by invoking the jurisdiction of the Tax Court in the first place. First, they consented only to have their cases resolved by legitimate Tax Court judges and not by a special trial judge. At the time the taxpayers' petitions were filed in 1982, § 7443A(b)(4) had not yet been enacted. *Second*, *CFTC* v. *Schor* forecloses any claim of automatic waiver at the Tax Court's threshold. In *Schor* this Court resolved the structural constitutional claim despite Schor's "express waiver," 478 U.S. at 849, of any such objection when he affirmatively invoked the CFTC's jurisdiction, urged that the alternative suit in the Art.III court be dismissed, and further insisted that the counterclaim that was the subject of his later constitutional objection be brought before the CFTC. *A fortiori*, petitioners — who are not voluntary litigants but citizens facing the coercive power of the government's revenue collection apparatus — cannot be deemed to have waived their structural objections by contesting the IRS deficiency notices in the Tax Court.

2. The Tax Court's Mid-Trial Proposal of Reassignment to a Special Trial Judge Was an "Offer" That Petitioners Could Not Refuse.

The circumstances of this case in any event rendered any "consent" on petitioners' part wholly involuntary. Even a "waiver of personal rights must, of course, be freely and voluntarily undertaken." *Pacemaker*, 725 F.2d at 543. As Judge (now Justice) Kennedy explained in that case, which involved the issue of a magistrate's authority to conduct a civil trial with the parties' consent:

> The purported waiver of the right to an Article III trial would not be an acceptable ground for avoiding the constitutional question if the alternative to the waiver were the imposition of serious burdens and costs on the litigant. If it were shown that the choice is between trial to a magistrate or the endurance of delay or other measurable hardships not clearly justified by the needs of judicial administration, we would be required to consider whether the right to an Article III forum had been voluntarily relinquished.

725 F.2d at 543.

Petitioners were plainly faced with just such a Hobson's choice when Judge Wilbur took a disability retirement from the Tax Court. Petitioners had by then wrestled with the trial for 19 months and had no meaningful choice but to allow the special trial judge to complete the proceedings and prepare findings and an opinion. The alternative was to start all over again and simply scrap a trial that had already generated 9,000 pages of transcript, hundreds of hours of videotape and 3,000 exhibits, and that had already consumed hundreds of thousands of dollars in costs and attorneys fees. The "imposition of [these] serious burdens and costs on the litigant" makes petitioners'

decision to "consent" to reassignment to the special trial judge involuntary. *Pacemaker*, 725 F.2d at 543. Accordingly, this is the *last* case in which a voluntary waiver of constitutional safeguards ought to be found.

CONCLUSION

For the reasons stated above, petitioners urge that the judgment below be reversed and remanded.

Respectfully submitted,

KATHLEEN M. SULLIVAN
Counsel of Record
BRIAN STUART KOUKOUTCHOS
1525 Massachusetts Avenue
Cambridge, Massachusetts 02138
(617) 495-4633

RICHARD J. SIDEMAN
MARTHA A. BOERSCH
SIDEMAN & BANCROFT
One Embarcadero Center
Suite 860
San Francisco, California 94111
(415) 392-1960
Counsel for Petitioners

March 1, 1991

FILED
MAR 8 1991
OFFICE OF THE CLERK

No. 90-762

IN THE
Supreme Court of the United States
OCTOBER TERM, 1990

THOMAS and SHARON FREYTAG, JOE and GLADYS WOMBLE, BERT and MILDRED TIMM, KENNETH and CANDACE MCCOIN,
Petitioners,
v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF OF ERWIN N. GRISWOLD AS AMICUS CURIAE

ERWIN N. GRISWOLD
Amicus—Counsel of Record
PATRICIA A. DUNN
Of Counsel for the Amicus
1450 G Street, N.W.
Washington, D.C. 20005
(202) 879-3898

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

BEST AVAILABLE COPY

QUESTION PRESENTED

Whether Congress has the power, under the Appointments Clause of the Constitution, to authorize the Chief Judge of the United States Tax Court to appoint special trial judges.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES—Continued

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-762

THOMAS and SHARON FREYTAG, JOE and GLADYS WOMBLE, BERT and MILDRED TIMM, KENNETH and CANDACE MCCOIN,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

BRIEF OF ERWIN N. GRISWOLD AS AMICUS CURIAE

INTRODUCTION

On February 19, 1991, this Court granted a motion by the *amicus* for leave to file this brief. This brief is filed to present to the Court a position that—while shared by the United States Tax Court itself (Pet. App. at A82-A87)—is supported by neither the petitioners nor the respondent in this case: that is, that the Tax Court is a "Court[] of Law" that may be authorized by Congress to appoint inferior officers consistent with the Appointments Clause of the Constitution.[1]

[1] The Court granted certiorari to review three issues. This brief, however, addresses only the second issue presented in the Petition, i.e., the propriety, under the Appointments Clause of the Constitu-

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

This case involves Article II, Section 2, of the Constitution of the United States, which is reproduced in Appendix E to the Petition (Pet. App. A99), and Section 7443A of the Internal Revenue Code, 26 U.S.C. § 7443A, which is reproduced in Appendix F to the Petition (Pet. App. A100).

STATEMENT

1. In 1924, Congress established "an independent agency in the executive branch of Government" to adjudicate certain disputes arising under the federal tax laws. Revenue Act of 1924, ch. 234, § 900(a), (k), 43 Stat. 253, 336, 338. This independent agency, named the Board of Tax Appeals ("Board"), consisted of limited-tenure Board members appointed by the President, with the advice and consent of the Senate. *Id.*, § 900(b), 43 Stat. 336. Congress gave the Board limited jurisdiction to decide certain pre-payment disputes, i.e., tax deficiencies and claims in abatement. *Id.*, §§ 274, 279, 43 Stat. 297, 300.

Over the next half-century, Congress took several steps to give this executive agency attributes more indicative of a court. *See* H. Dubroff, *The United States Tax Court, An Historical Analysis* 161-64 (1979). In 1926, just two years after creating the Board, Congress recognized that the Board's decisions were "judicial and not legislative or administrative" (S. Rep. No. 52, 69th Cong., 1st Sess. 37 (1926)), and provided for direct review of those decisions in the federal courts of appeals.

tion, of appointment of special trial judges by the Chief Judge of the Tax Court pursuant to the specific authorization of Congress. The *amicus* agrees with the Respondent on the first issue presented in the Petition. The *amicus* does not address the third question before the Court concerning waiver by the petitioners of their constitutional challenge.

Revenue Act of 1926, ch. 27, §§ 1001, 1003(a), 44 Stat. 9, 109-110. In 1942, while continuing the tribunal's status as an executive agency, Congress passed legislation that renamed both the Board and its members as the "Tax Court of the United States" and "judges," respectively. Revenue Act of 1942, ch. 619, § 504, 56 Stat. 798, 957. And, in 1948, Congress provided specifically that the Tax Court's decisions were reviewable in the federal courts of appeals under the same standards as those applicable to non-jury decisions of the federal district courts. Act of June 25, 1948, ch. 646, § 36, 62 Stat. 869, 991.

In 1969, Congress took the final step and changed the Tax Court's status from that of an executive agency to a court. Tax Reform Act of 1969, Pub. L. No. 91-172, § 951, 83 Stat. 487, 730. In the words of the statute, Congress established "a court of record to be known as the United States Tax Court," and it was explicit in saying that it took this action "under Article I of the Constitution of the United States." 26 U.S.C. § 7441; *see* S. Rep. No. 552, 91st Cong., 1st Sess. 303 (1969) (expressing intent to "make[] the Tax Court an Article I court rather than an executive agency").[2] Con-

[2] This action by Congress is supported by two clauses of Article I, § 8, of the Constitution—the power to "lay and collect taxes" (clause 1) and the power to make all laws "necessary and proper" to execute that authority (clause 18). Reference may also be made to the power given to Congress by Article 1, § 8, cl. 9, of the Constitution "[t]o constitute Tribunals inferior to the supreme Court." In his opinion in *Glidden Co. v. Zdanok*, 370 U.S. 530, 543 (1962), Justice Harlan said that this provision "plainly relates to the 'inferior Courts' provided for in Art. III, § 1; it has never been relied on for establishment of any other tribunals." It should be noted, though, that only two other Justices concurred in Justice Harlan's opinion. Three observations may be made: (1) no majority of this Court has ever *decided* that Article I, § 8, cl. 9, is limited to Article III courts; (2) had the Founding Fathers intended to limit clause 9 to Article III courts, they would have used the word "Courts," as used in Article III, rather than the broader word "Tribunals"; and (3) the

current with this change in status, Congress gave the Tax Court the authority, *inter alia*, to enforce its own process and to punish contempt of its orders; it also empowered the Tax Court to appoint full-time commissioners to assist its judges for indefinite terms. Pub. L. No. 91-172, § 956, § 958, 83 Stat. 732, 734.[3]

In 1984, after over a decade of gradually expanding the decision-making role of the Tax Court's commissioners (Pet. App. A90-A91), Congress changed the name of these commissioners to "special trial judges" and prescribed the current categories of proceedings in which they could render decisions. Tax Reform Act of 1984, Pub. L. No. 98-369, § 464, 98 Stat. 494, 824. Thus, in the current Section 7443A of the Internal Revenue Code, Congress authorized the Chief Judge of the Tax Court to "appoint special trial judges who shall proceed under such rules and regulations as may be promulgated by the Tax Court." 26 U.S.C. § 7443A(a). It further provided that the Chief Judge could assign special trial judges to hear (1) declaratory judgment proceedings; (2) proceedings under Section 7463 of the Code; (3) small cases involving less than $10,000; and (4) "any other proceeding which the chief judge may designate to be heard by the special trial judges of the court." 26 U.S.C. § 7443A(b). Congress provided, however, that these special trial judges could issue "the decision of the court" in only the first three types of proceedings. 26 U.S.C. § 7443A(c).

Appointments Clause is in Article II, where it is as relevant to Article I as it is to Article III.

There is no need to resolve this issue here since Article I, § 8, and the "necessary and proper" clause provide adequate authority for Congress to establish the United States Tax Court and to allocate to it an appropriate portion of the judicial power.

[3] This authority to appoint commissioners was not entirely new. Since 1939, as an executive agency, the Board had possessed the authority to appoint commissioners to assist the Board in particular cases. Pet. App. A90.

2. This case began with determinations of deficiencies against the petitioners, who had attempted to deduct losses, allegedly realized on investments in a tax shelter scheme, on their federal income tax returns. Pet. App. A2. Petitioners filed their petitions in the Tax Court for review of these determinations. Their cases were ultimately assigned for trial to a special trial judge of the Tax Court, who concluded that the tax shelter scheme consisted of sham transactions and that the petitioners owed additional taxes. *Id.* at A47. The Chief Judge adopted this decision of the special trial judge as the decision of the Tax Court. *Id.* at A14.[4]

The petitioners appealed to the United States Court of Appeals for the Fifth Circuit, arguing (1) that the Tax Court erred in holding that the tax shelter scheme was a sham, and (2) that the assignment of their cases to a special trial judge was contrary to both Section 7443A (b)(4) of the Internal Revenue Code and the Appointments Clause of the Constitution. The court of appeals, however, affirmed the decision of the Tax Court. Pet.

[4] The petitioners make much of the fact that "[t]he special trial judge's filing of his report and its verbatim adoption by Chief Judge Sterrett appear from the record to have been virtually simultaneous." Pet. Br. 8. Quite apart from the fact that the burden of proof on this question was on the taxpayer, the suggestion overlooks the fact that Chief Judge Sterrett acted in two different capacities in this case: (1) he was the judge assigned to review the work of the special trial judge—and there is nothing whatever in the record to show how long or how frequently he worked on this task—and (2) he was the Chief Judge of the Tax Court who, under Section 7460(b) of the Internal Revenue Code, had the responsibility to determine whether this case was one that should be "reviewed by the Tax Court" (that is, set down for *en banc* hearing). Since he was already familiar with the case because of his consideration of it under the first of these capacities, it is hardly surprising that, when the final draft came to him, he had already concluded that it was not a case that should be "reviewed by the Tax Court." In this situation, it was clearly his duty to enter the final order forthwith, when the report came back to him after his first review.

App. A1-A13. It concluded that the Code authorized the Tax Court to assign a special trial judge to hear petitioners' cases (*id.* at A6-A7), that the petitioners had waived any constitutional challenge to this appointment by consenting to a trial before a special trial judge (*id.* at A8 n.9), and that the Tax Court had properly sustained the disallowance of petitioners' claimed deductions (*id.* at A8-A13).[5]

SUMMARY OF ARGUMENT

Congress constitutionally vested the Chief Judge of the United States Tax Court with the authority to appoint special trial judges. The Appointments Clause of the Constitution makes clear that Congress may vest authority to appoint inferior officers, like the Tax Court's special trial judges, "in the President alone, in the Courts of Law, or in the Heads of Departments." Art. II, § 2. The Tax Court is plainly a "Court[] of Law" within the meaning of this Clause. It is a "court" created pursuant to Congress' powers under Article I of the Constitution; it exercises judicial power in interpreting the tax laws of the United States, subject to review in the Article III courts of appeals; and it functions in all respects like a court.

That the Tax Court is a legislative court, rather than an Article III constitutional court, does not mean that

[5] The constitutionality of the Tax Court as an Article I court has not been challenged in this case, and has been uniformly recognized by the courts of appeals that have reached this issue. *See Shenker v. Commissioner*, 804 F.2d 109, 114 n.6 (8th Cir. 1986); *Sauers v. Commissioner*, 771 F.2d 64, 69 n.6 (3d Cir. 1985), *cert. denied*, 476 U.S. 1162 (1986); *Simanonok v. Commissioner*, 731 F.2d 743, 744 (11th Cir. 1984); *Sparrow v. Commissioner*, 748 F.2d 914, 915 (4th Cir. 1984); *Knoblaugh v. Commissioner*, 749 F.2d 200, 202 (5th Cir. 1984), *cert. denied*, 474 U.S. 30 (1985); *Redhouse v. Commissioner*, 728 F.2d 1249, 1253 n.2 (9th Cir.), *cert. denied*, 469 U.S. 1034 (1984); *Knighten v. Commissioner*, 705 F.2d 777, 778 (5th Cir.), *cert. denied*, 464 U.S. 897 (1983).

it is not a "Court[] of Law" under the Appointments Clause. Nothing in the text of the Appointments Clause restricts the phrase "Courts of Law" in that manner. Rather, a fair and natural construction of those words leads to the conclusion that they encompass courts—including Article I courts—that administer, interpret and apply the laws of the United States. This construction comports with Congress' consistent and long-standing interpretation of the Appointments Clause and this Court's decisions sustaining the constitutionality of legislative courts.

Separation-of-powers principles do not require this Court to hold that the Tax Court is not a "Court[] of Law" or that it is, instead, a "Department." Congress made clear, in 1969, that the Tax Court is a "court"—not a department within the Executive Branch of the federal government. This designation does not pose significant separation-of-powers concerns. The structure of the Tax Court effectively shields the Chief Judge of the Tax Court from legislative efforts to exert undue influence over the appointments process; except by impeachment, applicable to all civil officers, Congress can remove neither the Tax Court Judges nor the appointed special trial judges. No genuine separation-of-powers concerns would thus be advanced by cloaking the Tax Court with the artificial designation of a "Department" for purposes of the Appointments Clause.

ARGUMENT

CONGRESS HAS POWER UNDER THE CONSTITUTION TO AUTHORIZE THE APPOINTMENT OF SPECIAL TRIAL JUDGES BY THE CHIEF JUDGE OF THE UNITED STATES TAX COURT

The Appointments Clause of the Constitution provides that "Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments." Art. II, § 2, cl. 2, last sentence. In Section 7443A of the Internal Revenue Code, Congress did "by Law vest" the Chief Judge of the Tax Court with the authority to appoint special trial judges. 26 U.S.C. § 7443A. These special trial judges, moreover, are properly deemed "inferior Officers" within the meaning of the Appointments Clause.[6] The constitutionality of the Chief Judge's appointment of these inferior officers thus turns on whether the Tax Court is a "Court[] of Law" (as the Tax Court and the *amicus* contend) or, alternatively, whether the Chief Judge is the "Head[] of [a] Department[]" (as the Respondent contends). The Tax Court's functions, viewed in light of the plain meaning and historical interpretation of the phrase "court of law," make plain that the Tax Court is a "Court[] of Law" empowered to appoint inferior officers under the Appointments Clause.

[6] *Cf. Morrison v. Olson*, 487 U.S. 654, 670-73 (1988) (independent counsel appointed under Ethics in Government Act was "inferior officer"); *Buckley v. Valeo*, 424 U.S. 1, 126 (1976) (commissioners of Federal Election Commission are at least "inferior officers"); *Matter of Hennen*, 13 Peters 230, 257-58 (1839) (clerks of the district courts are "inferior officers").

A. The Tax Court Is A "Court[] Of Law" Within The Meaning Of The Appointments Clause Of The Constitution

1. The Tax Court's functions serve to define its constitutional status and its role in the constitutional scheme. *See Williams v. United States*, 289 U.S. 553, 563-567 (1933).[7] The United States Tax Court is a "court of the United States" exercising judicial, rather than executive, legislative or administrative, power. As such, it naturally falls within the phrase "Courts of Law" as the Framers used those words in the Appointments Clause.

The Tax Court, which Congress created pursuant to its powers under Article I of the Constitution (*see* 26 U.S.C. § 7441), plainly functions as a court of law. Congress set up the Tax Court as an independent tribunal to interpret and apply the Internal Revenue Code in disputes between taxpayers and the Government; it thus exercises an appropriate segment of the "judicial power" of the United States. The Tax Court, moreover, dispenses that power in much the same way as the federal district courts—courts that are indisputably "Courts of Law." Indeed, the Tax Court has authority to punish contempt of the court by fine or imprisonment (26 U.S.C. § 7456(c); *see Trihimovich v. Commissioner*, 77 T.C. 252 (1981)); to issue injunctions (26 U.S.C. § 6213(a)); to enforce its decisions by ordering the Secretary of the Treasury to refund an overpayment determined by the

[7] This Court has adopted such a practical and functional approach in similar contexts. *See Forrester v. White*, 484 U.S. 219, 228 (1988) (whether judicial immunity applies to an act of a judge depends on whether the act is judicial in character); *Bowsher v. Synar*, 478 U.S. 714 (1986) (Congress may not exercise removal power over officer performing executive functions); *Humphrey's Executor v. United States*, 295 U.S. 608, 630-31 (1935) (President cannot discharge members of the Federal Trade Commission because the statutory functions of the Commission are not purely executive in nature).

court (26 U.S.C. § 6512(b)(2)); and to subpoena witnesses, order production of documents, administer oaths, and examine witnesses (26 U.S.C. § 7456(a)). All of these powers of the Tax Court are quintessentially judicial in nature.

The Tax Court's role in our tripartite form of government serves to underscore its status as a court of law within the meaning of the Appointments Clause. The decisions of the Tax Court are not subject to review by either the Congress or the President. Nor has Congress made them subject to intermediate review in the federal district courts. Rather, like the decisions of the federal district courts, the decisions of the Tax Court are directly appealable only to the United States Courts of Appeals, with ultimate review in this Court. *See* 26 U.S.C. § 7482(a). The Courts of Appeals, moreover, review those decisions "in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury." *Id.*

Thus, even before Congress expressly constituted the Tax Court as an Article I court and expanded its judicial powers in 1969, the Courts of Appeals properly recognized that the powers and functions of the Tax Court and its predecessors were judicial in nature. *See Uncasville Mfg. Co. v. Commissioner*, 55 F.2d 893, 897 (2d Cir. 1932) (Judge Learned Hand) (the Board of Tax Appeals "acts as a judicial body"); *Stern v. Commissioner*, 215 F.2d 701, 707 (3d Cir. 1954) (Tax Court's "powers are wholly judicial in character"); *Reo Motors Inc. v. Commissioner*, 219 F.2d 610, 612 (6th Cir. 1955) (stating that the Tax Court "is a court exercising inherently judicial functions and having the necessary judicial powers to carry out such functions"). The Tax Court's functions and role in the federal judicial scheme, accordingly, provide ample support for the conclusion

that it is a "Court[] of Law" under the Appointments Clause.[8]

2. Nothing in the simple reference to "the Courts of Law" in the Appointments Clause limits the power of appointment "to those courts created and existing under Article III as part of the Judicial Branch." Pet. Br. 33. It is, of course, true that "[t]he Constitution nowhere makes reference to 'legislative courts.'" *Glidden Co. v. Zdanok*, 370 U.S. 530, 543 (1962). But the fact that Article III courts are the only courts that the Constitution authorizes *eo nomine* does not mean, as petitioners argue (Pet. Br. 34), that Article II's reference to "Courts of Law" is limited exclusively to such courts.

a. The *text* of the Appointments Clause plainly does not limit "Courts of Law" to only those courts established under Article III of the Constitution. It nowhere specifically provides that Congress can vest appointment powers only in "one supreme Court" and other courts created under Article III, or only in non-"public rights" tribunals that exercise broad common law jurisdiction. Nor is there reason to believe that the Framers intended the simple words "Courts of Law" to carry such a restrictive meaning; indeed, although the Framers adopted this language in the Appointments Clause with little comment, they plainly intended to give Congress broad discretion to determine where appointment authority should lie. *See*

[8] The Respondent agreed with this common-sense interpretation of the Appointments Clause in the court below, advocating the position that the Tax Court is a "Court[] of Law" under that Clause. *See* Brief for the Appellee Commissioner of Internal Revenue, Nos. 89-4436, 4439, 4440, & 4450 (5th Cir.), at 47-51. In a later case presenting this same constitutional issue, however, the Respondent abandoned that position, arguing that the Tax Court is not a "Court[] of Law," but that it can be regarded as a "Department" within the Executive Branch. *See* Brief for the Appellee Commissioner of Internal Revenue, *Samuels, Kramer & Co. v. Commissioner*, Nos. 90-4060 & 90-4064 (2d Cir., decision pending), at 34-48.

Morrison v. Olson, 487 U.S. at 673-74. To give the words "Courts of Law" anything but their plain and natural meaning—i.e., "courts" that administer, interpret and apply the laws of the United States (*see* Black's Law Dictionary, at 323 (5th ed. 1989))—would do violence to both the text and intent of the Constitution.[9]

b. This fair and natural construction of the phrase "Courts of Law" comports with Congress' consistent and long-standing interpretation of the Appointments Clause. "[F]rom the earliest days of the Republic" (*Northern Pipeline Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 64 (1982)), Congress provided for the creation of "legislative" courts (including those empowered to adjudicate "public rights") and authorized those courts to appoint inferior officers of the United States—thus showing the clear understanding of Congress that the Appointments Clause did not preclude these courts from making such appointments. Because "'traditional ways of conducting government . . . give meaning' to the Constitution" (*Mistretta v. United States*, 488 U.S. 361, 401 (1989), quoting *Youngstown Sheet & Tube Co. v. Sawyer*, 343 U.S. 579, 610 (1952) (Frankfurter, J., concurring)), this long-established and time-honored interpretation provides compelling evidence that Article I courts are "Courts of Law" under the Appointments Clause.

Since the early 1800s, Congress regularly granted territorial courts the authority to appoint their own clerks

[9] This Court's decision in *Buckley v. Valeo*, 424 U.S. 1 (1976), does not compel a contrary conclusion. While the Court in *Buckley* paraphrased the Appointments Clause to allow the appointment of inferior officers "by the President alone, by the heads of departments, or by the Judiciary" (*id.* at 132), the Court did not hold, as petitioners suggest (Pet. Br. 33-34), that "Courts of Law" consist only of the Article III Judiciary. Indeed, the appointment authority of the "Courts of Law" was not before the Court in *Buckley*; the Court was, instead, concerned with whether the appointment of Federal Elections Commissioners by Congress was constitutional under the Appointments Clause.

of court who, as of at least 1839, were undeniably "inferior officers" within the meaning of the Appointments Clause. *See Matter of Hennen*, 13 Peters 230, 257-58 (1839). For example, in 1804, Congress created the courts of the territory of Orleans and vested them with "judicial power." Act of Mar. 26, 1804, ch. 38, §§ 5-7, 2 Stat. 283, 284-85. It provided for Presidential appointment of judges for these courts who, with the advice and consent of the Senate, would serve for four-year terms, and granted these judges authority to "appoint their own clerk." *Id.* The territorial courts that Congress subsequently created followed this same model: Congress (1) vested "the judicial power"—using those words—in courts whose judges were appointed by the President with the advice and consent of the Senate for a term of years and (2) granted these non-Article III judges the authority to appoint clerks of the court. *See, e.g.*, Act of June 4, 1812, ch. 95, § 10, 2 Stat. 743, 746 (territory of Missouri); Act of Mar. 2, 1819, ch. 49, § 7, 3 Stat. 493, 495 (territory of Arkansaw); Act of Mar. 30, 1822, ch. 13, § 6, 3 Stat. 654, 656 (territory of Florida); Act of June 12, 1838, ch. 96, § 9, 5 Stat. 235, 237-39 (territory of Iowa); Act of Mar. 2, 1853, ch. 82, § 9, 10 Stat. 172, 175-76 (territory of Washington); Act of Mar. 3, 1863, ch. 117, § 9, 12 Stat. 808, 811-12 (territory of Idaho); Act of Apr. 30, 1900, ch. 339, § 86, 31 Stat. 141, 158 (territory of Hawaii); Act of Mar. 2, 1917, ch. 145, § 41, 39 Stat. 951, 965 (territory of Puerto Rico); Act of Aug. 1, 1950, ch. 512, § 24(c), 64 Stat. 384, 390 (Guam); *cf.* Act of July 22, 1954, ch. 558, § 27, 68 Stat. 497, 507 (granting territorial court of the Virgin Islands authority to appoint a U.S. Attorney to fill a vacancy until the vacancy was filled by Presidential appointment following confirmation). Congress likewise granted similar authority to courts in the District of Columbia. *See* Appendix, *infra*, at 25-26 (summarizing history of District of Columbia courts).[10]

[10] Petitioners seek to render this congressional action "wholly inapposite" because Congress established these courts pursuant to

Congress has similarly created a number of other non-Article III courts and empowered them, like the territorial courts, to appoint inferior officers of the United States. For example, Congress in 1855 created the Court of Claims, which until 1953 was recognized as an Article I court (*Glidden Co. v. Zdanok*, 370 U.S. 530, 586-87 (1962) (Clark, J., concurring)), and granted the court the authority to appoint commissioners and a chief clerk of the court. Act of Feb. 24, 1855, ch. 122, §§ 3, 11, 10 Stat. 612, 613-14.[11] In 1891, Congress created the Court of Private Land Claims, another Article I court (*United States v. Coe*, 155 U.S. 76, 85-86 (1894)), and granted the court authority to appoint a clerk and deputy clerk. Act of Mar. 3, 1891, ch. 539, 26 Stat. 854, 855. And, in 1902, Congress created the Choctaw and Chickasaw Citizenship Court, an Article I court whose judges similarly were granted the authority to appoint a clerk and deputy

its "plenary" powers with respect to the District of Columbia and the territories. Pet. Br. 35 n.33. That Congress established the District of Columbia courts and the territorial courts under Article I, § 8, cl. 17, and Article IV, § 3, cl. 2, respectively, however, is a distinction without a difference in this case. The powers given to Congress with respect to taxes are no less "plenary" than those with respect to the District of Columbia and the territories. Congress has "plenary" power "[t]o lay and collect taxes . . ." (Art. I, § 8, cl. 1) and "[t]o make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States or in any Department or Officer thereof" (Art. I, § 8, cl. 18).

[11] In 1986, Congress gave the Claims Court—which is now an Article I court with judges of limited tenure—authority to appoint "special masters" to make findings of fact and conclusions of law under the National Vaccine Injury Compensation Program, 42 U.S.C. § 300aa-12(c). *See* Pub. L. No. 99-660, § 2112(c), 100 Stat. 3761 (1988). Petitioners contend that this appointment authority, like the Tax Court's appointment authority, violates the Appointments Clause, relying on the President's statement to that effect when he signed the legislation creating the vaccine special masters. Pet. Br. 40. That statement, however, is entitled to no binding weight in determining the meaning of the Constitution—a task that is ultimately for this Court.

clerk. Act of July 1, 1902, ch. 1362, § 33, 32 Stat. 641, 648; *see Wallace v. Adams*, 204 U.S. 415 (1907). All of these Article I courts, granted widely varying statutory jurisdictions, are identical in a few crucial respects: each is described by Congress as a "court"; each specifically has been vested by Congress with "judicial power," generally in those words; and each has been recognized by this Court as a "court" properly constituted pursuant to the Article I powers of Congress.[12]

Congress' long and undisturbed interpretation of the Constitution with respect to "legislative courts" is entitled to substantial deference. *See Mistretta v. United States*, 488 U.S. 361, 401 (1989); *Youngstown Sheet & Tube Co. v. Sawyer*, 343 U.S. at 610. There can be little doubt that, in following its time-honored practice of granting these Article I courts the power to appoint inferior officers of the United States, Congress understood them to be "Courts of Law" within the meaning of the Appointments Clause. There is likewise little doubt that the Tax Court—which, for present purposes, is indistinguishable from these other Article I courts—can constitutionally be granted power to appoint its own inferior officers.

c. This Court's decisions upholding a variety of non-Article III courts similarly provide strong support for the conclusion that the Tax Court is a "Court[] of Law" within the meaning of the Appointments Clause. In the face of constitutional challenges to non-Article III courts —based on the literalistic argument (similar to petition-

[12] More recently, Congress established two more Article I courts: the United States Court of Veterans Appeals (38 U.S.C. § 4051 *et seq.*), whose decisions are subject to review in the United States Court of Appeals for the Federal Circuit and, ultimately, this Court (38 U.S.C. § 4092), and the United States Court of Military Appeals (10 U.S.C. §§ 942-44), whose decisions are subject to direct certiorari review in this Court (28 U.S.C. § 1259), a jurisdiction that would be unconstitutional unless the Court of Military Appeals is a "court" within this Court's appellate jurisdiction.

ers' argument here) that only Article III courts can exercise the "judicial power" of the United States—this Court has repeatedly sustained the constitutionality of the creation by Congress of so-called "legislative courts."

In *American Insurance Co. v. Canter*, 1 Peters 511 (1828), the first case to examine this issue, this Court held that the territorial court of Florida was a non-Article III legislative court and that it had proper jurisdiction to hear and decide admiralty cases. *Id.* at 546. In creating this court, Congress had vested it with "judicial power" and had provided that "[e]ach judge shall appoint a clerk for his respective court" (Act of March 30, 1822, ch. 13, 3 Stat. 654, 656)—evidencing the clear understanding of Congress that the "judicial power" was not limited to Article III courts and that legislative courts were "Courts of Law" under the Appointments Clause. Chief Justice Marshall, writing for the Court, specifically recognized the former proposition—that the judicial power of the United States was not limited to the judicial power defined under Article III and could be exercised by "legislative courts":

> These Courts . . . are legislative Courts, created in virtue of the general right of sovereignty which exists in the government, or in virtue of that clause which enables Congress to make all needful rules and regulations, respecting the territory belonging to the United States. The jurisdiction with which they are invested is not a part of that judicial power which is defined in the 3d article of the Constitution, but is conferred by Congress, in the execution of those general powers which that body possesses over the territories of the United States.

1 Peters at 546. While the Court had no occasion to address the appointment powers of these courts, Chief Justice Marshall carefully reviewed the powers granted the territorial court of Florida—without in any way intimating that any of the powers granted to the court were contrary to the Constitution or that the territorial

court was anything other than a court of law. *See id.* at 543-46.

This Court's later decisions involving Article I courts similarly refer to these tribunals as courts that exercise the "judicial power" of the United States. In *Ex parte Bakelite Corp.*, 279 U.S. 438 (1929), the unanimous Court held that the Court of Customs Appeals was an Article I court. In the Court's words, "[t]hat the court is a court of the United States is plain; but this is quite consistent with its being a legislative court." *Id.* at 460. Following similar reasoning, this Court (again unanimously) held in *Williams v. United States*, 289 U.S. 553 (1933), that the original Court of Claims was an Article I court, stating:

> The Court of Claims . . . undoubtedly . . . exercises judicial power, but the question still remains—and is the vital question—whether it is the judicial power defined by Art. III of the Constitution.
>
> That judicial power apart from that article may be conferred by Congress upon legislative courts, as well as upon constitutional courts, is plainly apparent from the opinion of Chief Justice Marshall in *American Insurance Co. v. Canter*, 1 Pet. 511, 546, dealing with the territorial courts. . . . [T]he legislative courts possess and exercise judicial power—as distinguished from legislative, executive, or administrative power—although not conferred in virtue of the third article of the Constitution.
>
> * * * *
>
> If the power exercised by legislative courts is not *judicial* power, what is it? Certainly it is not legislative, or executive, or administrative power, or any imaginable combination thereof.

Id. at 565-67 (emphasis in original). *See also Northern Pipeline Co. v. Marathon Pipe Line Co.*, 458 U.S. at 63-70 (discussing historically recognized exceptions to the provision that the "judicial power" is vested in Article

III courts); *Palmore v. United States*, 411 U.S. 389, 397-404 (1973).

The premise of the petitioners' and respondent's positions—that Article III courts are the only courts that the Constitution authorizes or intends to exercise the judicial power of the United States—has thus been rejected again and again by this Court. This Court has consistently held that courts established pursuant to Article I of the Constitution may, within relevant limits, exercise the judicial power of the United States. Because these Article I courts exercise *judicial* power, it follows logically and, indeed, readily that these courts are "Courts of Law" within the natural meaning of the Appointments Clause. That the Framers did not foresee this development provides no more reason for denying its effect than in other cases, such as the applicability of Article I, § 8, clauses 12 and 13, to an Air Force, or of the Fourth Amendment to telephone calls.

3. Petitioners' concern that this interpretation of the Appointments Clause "would allow the diffusion of appointment power throughout the breadth and depth of the federal bureaucracy" (Pet. Br. 41, 37) is overstated. Interpreting the phrase "Courts of Law" to include Article I courts hardly invites Congress to disregard the mandates of the Constitution and confer appointment authority on virtually every body outside of Congress—even on those that do not fall within the categories of "Courts of Law" or "Heads of Departments." Indeed, the petitioners themselves concede that this case will not affect the selection of many other adjudicatory officers and agents who, like administrative law judges, serve outside these categories within the federal government. *Id.* at 38-39. Petitioners point to nothing but speculation to support the notion that Congress will abuse its authority in granting appointment powers to Article I courts—an authority that it has used appropriately but sparingly in the past.

Sustaining petitioners' position—that Congress cannot constitutionally confer appointment authority on Article I "courts of law"—would create a bizarre and untenable limitation on congressional power. Petitioners' position would mean that Congress can establish an Article I court to act as a judicial body and exercise the judicial power of the United States, but cannot grant this same judicial body the authority to appoint inferior officers necessary for carrying out these judicial duties. Nothing in the Constitution compels such a mechanical and artificial result.

B. Separation-Of-Powers Principles Do Not Bar Congress From Granting The Tax Court Appointment Power As A "Court[] Of Law" Under The Appointments Clause

Respondent will presumably contend that separation-of-powers concerns should lead this Court to deem the United States Tax Court a "Department[]" within the Executive Branch rather than a "Court[] of Law." That position is contrary to Congress' clear and direct action in 1969 and has no sound basis in this Court's separation-of-powers principles. Those principles do not preclude Congress from granting Article I courts, such as the Tax Court, appointment power as "Courts of Law" under the Appointments Clause.

1. The contention that the Tax Court is really a "Department" rather than a "Court" is contrary to both the intent of Congress and the intent of the Framers of the Constitution. In 1969, recognizing the impropriety of "one executive agency . . . sitting in judgment on the determinations of another executive agency" (S. Rep. No. 552, 91st Cong., 1st Sess. 302 (1969)), Congress made clear its intent to change the Tax Court's status from that of (nominally) an executive agency to a "court of record" created under Article I of the Constitution. *See* Tax Reform Act of 1969, Pub. L. No. 91-172, § 951, 83 Stat. 730; S. Rep. No. 552, 91st Cong., 1st Sess. 303 (1969) (Congress intended to "make[] the Tax Court an

Article I court rather than an executive agency"). At the same time, it reaffirmed the power of the "court" thus established—like the many other non-Article III courts that it had created—to appoint inferior officers. Pub. L. No. 91-172, §§ 956, 958, 83 Stat. 732, 733. To suggest that the Tax Court is a Department, merely because it was once deemed a part of the Executive Branch, ignores this unequivocal act of Congress.[13]

Deeming the Tax Court to be a "Department" for purposes of the Appointments Clause likewise contravenes the intent of the Framers. Over a century ago, in *Matter of Hennen*, 13 Peters 230, 257-58 (1839), this Court held that the Framers intended that the constitutional power to appoint inferior officers was "to be exercised by the department of government to which the officer to be appointed *most appropriately* belonged" (emphasis added). Like the court clerks at issue in *Hennen*, the Tax Court's special trial judges "most appropriately belong[]" to the courts of law—not an executive department. The Tax Court exercises *only* judicial power. *See* H. Dubroff, *The United States Tax Court, An Historical Analysis*, Pt. VII, 395-493 (1979); *Stern v. Commissioner*, 215 F.2d 701, 707 (3d Cir. 1954) (the Tax Court "has never been given any administrative powers or functions nor has it ever had any investigatory, regulatory or policy-making duties or powers"). The Tax Court has no nonjudicial functions: it has no administrative duties or powers, no rulemaking authority (other than to adopt rules of procedure for the Tax Court itself, clearly a judicial function), no policy-making discretion, and no authority to conduct investigations or initiate legal actions. Embracing this Article I court within the phrase

[13] If the Tax Court is a "Department," then the Claims Court must be too. But to say that the Tax Court and the Claims Court—and the territorial courts, the District of Columbia courts, the Choctaw and Chickasaw Citizenship Court, and the Court of Private Land Claims among others—are "Departments" within the meaning of the Appointments Clause is surely fantasy.

"Courts of Law"—as opposed to forcing it artificially into the category of an executive "Department"—thus plainly fulfills the purpose of the Framers of the Constitution in adopting the Appointments Clause.[14]

2. Of course, the Framers of the Constitution clearly drafted the Appointments Clause with an eye toward maintaining a balance of power between the President and Congress. *See Buckley v. Valeo*, 424 U.S. 1, 130-131 (1975); *Morrison v. Olson*, 487 U.S. 654, 674 (1988).

[14] In the brief in the *Samuels, Kramer & Co.* case in the Second Circuit, Respondent's counsel attempted to find contrary evidence of the Framers' intent in the provision made by Congress, in one of the first statutes that it passed, for compensating judges (among other officers) of the Northwest Territory. This statute was entitled "An Act for Establishing the Salaries of the Executive Officers of Government, with their Assistants and Clerks." Act of September 11, 1789, ch. 13, 1 Stat. 67. Based on this Act's title, Respondent contended that the Framers viewed non-Article III courts as executive departments for purposes of the Appointments Clause. This reads into the title—perhaps written by a necessarily inexperienced clerk—more than it will bear.

The title of an Act of Congress is rarely a good indicator of legislative understanding and intent (*see Brotherhood of Railroad Trainmen v. Baltimore & Ohio RR.*, 331 U.S. 519, 528 (1947); *Mohegan Tribe v. State of Connecticut*, 638 F.2d 612, 620 (2d Cir. 1980), *cert. denied*, 452 U.S. 968 (1981); *United States v. Roemer*, 514 F.2d 1377, 1380 (2d Cir. 1975)), especially where, as here, this 1789 enactment dealt with setting salaries for already-established positions and evidenced no deliberate intent to categorize the judges of the courts as "Executive" officers. Indeed, the territorial government of the Northwest Territory was created not by the first Congress assembled under the Constitution, but by the Continental Congress in 1787. Act of Aug. 7, 1789, ch. 8, 1 Stat. 50, 51 note (a). This territorial government established before "separation of powers" became a part of the Constitution, unlike the territorial governments later created by Congress, did not maintain strict divisions among the judicial, legislative and executive branches. Indeed, under the Ordinance of 1787, the judges, along with the governor, were the legislative body of the territory, until the population reached a stated figure. This negates any inference that Congress' reference to territorial "executives" in salary-setting legislation carried any substantive meaning at all. *Id.*

But this separation-of-powers concern provides no reason to deprive the Tax Court of its "Court[] of Law" status and undervalue it, instead, with the artificial designation of a "Department."

Sustaining the Tax Court's power, as a court of law, to appoint inferior officers does not pose the "concern of encroachment and aggrandizement that has animated our separation-of-powers jurisprudence." *Mistretta v. United States*, 488 U.S. at 382; *see Morrison v. Olson*, 487 U.S. at 696. The structure of the Tax Court effectively shields the Chief Judge of the Tax Court from congressional efforts to exert undue influence over the appointments process. Congress has no power to remove Tax Court judges; those judges are appointed by the President, with the advice and consent of the Senate, for terms of 15 years (26 U.S.C. § 7443(b), (e)) and (though subject to impeachment like all civil officers) may be removed only by the President, after notice and opportunity for a public hearing, "for inefficiency, neglect of duty, or malfeasance in office, but for no other cause." 26 U.S.C. § 7443(f). Congress, moreover, has retained no power to review or supervise the Tax Court's appointment of special trial judges; it has no right to demand that a special trial judge, who serves at the pleasure of the Chief Judge of the Tax Court, be selected or subsequently removed.[15] The absence of real separation of powers concerns is thus plain from both this structure and the dearth of evidence, over the 200-year

[15] For this reason, the petitioners' passing reference to this Court's decision in *Bowsher v. Synar*, 478 U.S. 714, 730-31 (1986), is unpersuasive. Pet. Br. 36. In that case, this Court concluded that Congress could not entrust the Comptroller General of the United States with executive powers while retaining the authority to remove him from office. 478 U.S. at 726-32. This concern for the separation of powers between the Legislative and Executive Branches is plainly absent here. The statute involved here gives Congress no power of removal over the Tax Court and its judges.

history of legislative courts, of undue congressional encroachment into the appointments process.[16]

Separation-of-powers principles do not require this Court to treat the Tax Court as a "Department"—rather than a court of law—for Appointments Clause purposes. Respondent's concern that courts without the tenure and salary protections of Article III should not wield appointment authority appears not to be a concern reflected in the Appointments Clause generally or in this case particularly. Indeed, the Appointments Clause allows officers of the Executive Branch, who do not enjoy such tenure or salary protections, to appoint inferior officers as well. Thus, no significant separation-of-powers interest would be served by adopting the novel and highly artificial position that the Tax Court is a "Department[]" rather than a "Court[] of Law" under the Appointments Clause. Neither alternative affects congressional authority over the appointments process in any way or limits the appointment powers of the President in any inappropriate or burdensome way.

CONCLUSION

The "necessary and proper" clause of Article I, § 8, of the Constitution is comprehensive language intended to give Congress the power to see that the governmental structure is coherent and effective. Congress has met that challenge from the earliest days by allocating appropriate parts of the judicial power to Article I courts. To hold, at this late date, that Congress lacks authority to give these courts relevant appointment powers is not a neces-

[16] Vesting such appointment authority in an Article I court likewise does not encroach on powers that rightfully belong to the Article III courts. *Cf. Morrison v. Olson*, 487 U.S. at 673-77 (recognizing that Congress has discretion under the Appointments Clause to provide for interbranch appointments). The appointments at issue here—an Article I court's appointments of its own inferior officers—do not affect or diminish the powers of the Article III courts.

sary construction of the words of the Constitution. It is more inflexible than is appropriate in the construction of a Constitution that was intended to establish a workable government.

This Court should hold that the United States Tax Court is a "Court[] of Law" within the meaning of the Appointments Clause and that Congress may properly vest it with the authority to appoint inferior officers of the United States.

Respectfully submitted,

ERWIN N. GRISWOLD
Amicus—Counsel of Record
PATRICIA A. DUNN
Of Counsel for the Amicus
1450 G Street, N.W.
Washington, D.C. 20005
(202) 879-3898

March 8, 1991

APPENDIX

THE DISTRICT OF COLUMBIA COURTS

By Section 3 of the Act of February 27, 1801, ch. 15, 2 Stat. 103, 105-106, Congress created the circuit court for the District of Columbia, with three judges "to hold their respective offices during good behaviour." It also provided that "said court shall have power to appoint a clerk of the court." *See also* Act of March 3, 1801, ch. 24 § 9, 2 Stat. 115, 116 (authorizing "the chief judge, with one of the associate justices of the said court, to make such appointments").

In the last half of the nineteenth century, Congress revised the court system in the District of Columbia, and established the Supreme Court of the District. In 1893 (Act of Feb. 9, 1893, ch. 74, 27 Stat. 434), the Court of Appeals of the District was established, following the New York nomenclature. Over the years, there were a number of decisions by this Court in which courts in the District were regarded as "legislative courts," created under Article I. *Kendall v. United States*, 12 Peters 524, 619 (1838); *Postum Cereal Co. v. California Fig Nut Co.*, 272 U.S. 693, 700 (1927); *Ex parte Bakelite Corp.*, 279 U.S. 438, 455 (1929); *Federal Radio Commission v. General Electric Co.*, 281 U.S. 464, 468 (1930) ("the courts of the District of Columbia are not created under the judiciary article of the Constitution but are legislative courts . . ."). Then, in *O'Donoghue v. United States*, 289 U.S. 516 (1933), the Court held that these District of Columbia courts were created under *both* Article I and Article III. This new approach by this Court does not negate the fact that, pursuant to a number of decisions here, the District of Columbia courts were regarded as Article I courts over a period of 130 years, and Congress must have acted with that understanding.

In addition to the D.C. Superior Court and the D.C. Court of Appeals, there have been, over the years, a number of purely local courts in the District. By 1969, these were designated as the Court of General Sessions, the Juvenile Court, and the D.C. Tax Court. In 1970, Congress established a new set of local courts in the District of Columbia, designated as the Superior Court of the District (which consolidated the previous local courts), and the D.C. Court of Appeals. The judges of these courts were given limited tenure. Congress specifically provided that these courts were "established pursuant to Article I of the Constitution." D.C. Code § 11-101(2), enacted by the Act of July 29, 1970, Pub. L. No. 91-358, 84 Stat. 473, 475. In *Palmore v. United States*, 411 U.S. 389 (1973), this Court decided that these courts were validly created as Article I courts.

By the Act that established these local District of Columbia courts, Congress authorized the judges of these courts to appoint an Executive Officer of the District of Columbia courts, who is responsible for the administration of the court system. D.C. Code Ann. §§ 11-1701, -1703. As with the territorial courts, Congress has stated that these local District of Columbia courts are vested with "judicial power." D.C. Code Ann. § 11-101, enacted by the Act of July 29, 1970, Pub. L. No. 91-358, 84 Stat. 473, 475, 508-510.

Corrected Copy

(8)

No. 90-762

Supreme Court, U.S.
FILED
APR 3 19
OFFICE OF THE CL

In the Supreme Court of the United States

OCTOBER TERM, 1990

THOMAS FREYTAG, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT

KENNETH W. STARR
Solicitor General

SHIRLEY D. PETERSON
Assistant Attorney General

JOHN G. ROBERTS, JR.
Deputy Solicitor General

STEPHEN J. MARZEN
Assistant to the Solicitor General

GARY R. ALLEN
STEVEN W. PARKS
Attorneys

Department of Justice
Washington, D.C. 20530
(202) 514-2217

BEST AVAILABLE COPY

61

QUESTIONS PRESENTED

1. Whether a special trial judge of the Tax Court could be assigned to hear and report on petitioners' cases under 26 U.S.C. 7443A(b)(4).

2. Whether petitioners' consent to have their cases heard by a special trial judge waived their right to challenge his appointment on the basis of the Appointments Clause, Art. II, § 2, Cl. 2.

3. Whether the duties of a special trial judge in hearing and reporting on a case may be performed only by an "Officer of the United States," and, if so, whether the appointment of special trial judges by the chief judge of the Tax Court, in accordance with 26 U.S.C. 7443A, satisfies the requirements of the Appointments Clause.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

Cases—Continued: Page

Cases—Continued: Page

In the Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-762

THOMAS FREYTAG, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the court of appeals, Pet. App. A1-A13, is reported at 904 F.2d 1011. The opinion of the United States Tax Court, Pet. App. A14-A69, is reported at 89 T.C. 849.

JURISDICTION

The judgment of the court of appeals was entered on July 6, 1990. A petition for rehearing was denied on August 15, 1990. Pet. App. A97-A98. The petition for a writ of certiorari was filed on November 13, 1990, and granted on January 22, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Pertinent constitutional and statutory provisions are reprinted in an Appendix to this brief.

STATEMENT

Petitioners attempted to deduct on their income tax returns large "losses" supposedly incurred as a result of their participation in a tax shelter scheme. When the Commissioner of Internal Revenue disallowed those deductions, petitioners filed petitions in the Tax Court. Trial began before a regular judge of the Tax Court,[1] but that judge became ill shortly after trial began. A special trial judge[2] was assigned to complete the trial, which was videotaped so that the regular judge could view the testimony and ultimately render the decisions.

After all the evidence was taken, however, the regular judge became too ill to decide the cases, and he retired as an active judge. Petitioners then consented to having the special trial judge prepare findings and a proposed opinion to enable another regular judge of the Tax Court to decide their cases. J.A. 8-9, 13-14. The special trial judge's report proposed findings that the tax shelter in which petitioners participated was a sham and that petitioners entered into the shelter primarily to avoid payment of income taxes. Pet. App. A47. The chief judge of the Tax Court adopted the special trial judge's report and entered decisions in favor of the Commissioner. *Id.* at A14. The court of appeals affirmed. *Id.* at A1-A13.

1. Each of the petitioners invested in a commodity tax straddle program operated by First Western Government Securities (First Western). Stated simply, petitioners informed First Western how much tax loss they wished to secure and First Western charged petitioners fees of 7 to 8% of the desired losses. The fees supposedly were

---

[1] The Tax Court is comprised of 19 judges who are nominated by the President and confirmed by the Senate. 26 U.S.C. 7443.

[2] A special trial judge is appointed by the chief judge of the Tax Court. 26 U.S.C. 7443A(a). The Tax Court currently employs 14 special trial judges. Special trial judges receive 90% of the salary of regular Tax Court judges and do not serve fixed terms. 26 U.S.C. 7443A(d).

paid for contracts to take or deliver Government mortgage-backed securities approximately 14 to 22 months in the future. In fact, no market in those securities existed so far in the future and no securities were ever delivered. Instead, First Western created investment portfolios on a computer in which petitioners would simultaneously contract to buy securities at some future date (the "long" leg of the straddle) and sell similar securities at another future date (the "short" leg of the straddle). If permitted by the Internal Revenue Code, the straddle scheme would have allowed petitioners to "cancel" the loss leg and deduct the loss against that year's ordinary income, while at the same time holding open the gain leg until it could be closed out in a later year, as an offsetting transaction involving a "sale or exchange," 26 U.S.C. 1221, thereby deferring recognition of income and reporting that income as capital gain. Pet. App. A3-A5, A8-A9, A14-A15, A19 n.6, A26.

2. The Commissioner disallowed the "loss" deductions claimed by petitioners with respect to their "investments" in First Western, and they, along with some 3,000 other participants in that scheme, petitioned the United States Tax Court for a redetermination of the resulting deficiencies. Petitioners' cases, together with six others, were chosen as test cases and consolidated for trial. Pet. App. A5-A6.

Trial commenced in December of 1984 before the Honorable Richard C. Wilbur, a regular judge of the Tax Court. Judge Wilbur became ill shortly after the trial began. Chief Judge Samuel B. Sterrett thereupon assigned the cases to Special Trial Judge Carleton D. Powell to conduct the remainder of the evidentiary proceedings. Those proceedings were videotaped so that Judge Wilbur could view the testimony, prepare a report, and render the decisions when he recovered his health. None of the petitioners objected to this assignment. Pet. App. A5-A6.

After all the evidence was taken, Judge Wilbur learned that his medical condition would not allow him to prepare the report in petitioners' cases.[3] By order dated July 23, 1986, Chief Judge Sterrett notified the parties that—unless they objected—he would assign Special Trial Judge Powell to prepare the report in their cases in accordance with 26 U.S.C. 7443A(b)(4), and that action on the report would be taken "by Judge Wilbur, or if not by this Division of the Court."[4] J.A. 9. One taxpayer (Wilhide, Inc.) objected to the assignment, J.A. 4, and its case was severed, Pet. App. A27 n.16; J.A. 6. The remaining test case taxpayers, including petitioners, agreed to the assignment on the understanding that Judge Wilbur or Chief Judge Sterrett would review Special Trial Judge Powell's report and make the decision of the Tax Court. J.A. 10-11; see 26 U.S.C. 7443A(c).

The special trial judge's report recommended that petitioners' deductions not be allowed. He proposed findings that "[t]he transactions between First Western and its customers were illusory and fictitious" and were "entered into primarily, if not solely, for tax-avoidance purposes." Pet. App. A47. His report described a tax shelter scheme in which First Western's ability to "control[] losses" through its computer system was so "fine[ly]-tune[d]" that it could "reach any result" its clients desired. *Id.* at A50. The computer-created "market" in which petitioners "invested" was so artificial that it "could not have existed if there had been any real economic substance to its program." *Id.* at A54. In reality, "First Western's world consisted of a computer spitting out paper showing huge transactions that had no economic significance except in petitioners' attempts to raid Federal and State fiscs." *Ibid.* The report also con-

[3] Judge Wilbur's disability ultimately compelled him to retire from active service on the Tax Court and he assumed senior status on April 1, 1986. J.A. 8.

[4] Pursuant to 26 U.S.C. 7444(c), the chief judge has designated each judge sitting alone as a "division" of the Tax Court.

cluded that petitioners could be sanctioned under 26 U.S.C. 6673 because their litigating position was "frivolous"; rather than recommending the imposition of such sanctions, however, the report proposed only to warn other participants in the First Western scheme that petitioners' cases would be "the last free bites of that apple." Pet. App. A64.

The special trial judge's report was reviewed by Chief Judge Sterrett, who, on October 21, 1987, entered an order adopting the special trial judge's proposed findings and opinion and holding that petitioners' straddle transactions with First Western were shams and, in the alternative, that petitioners were not entitled to loss deductions because they had not entered into the transactions primarily for profit. Decisions were subsequently entered in favor of the Commissioner in accordance with that opinion by Judge Sterrett's successor as chief judge of the Tax Court, the Honorable Arthur L. Nims, III. Pet. App. A6, A14, A47-A65.

3. Petitioners appealed on the grounds that the Tax Court erred in finding that the transactions they entered into with First Western were shams, and that they had not intended to make a profit.[5] For the first time, petitioners also argued that the assignment of their cases to the special trial judge was unlawful. They contended that 26 U.S.C. 7443A(b)(4) allows special trial judges to hear and file reports only in minor tax cases. In addition, they contended that appointment of special trial judges by the chief judge of the Tax Court, as authorized by 26 U.S.C. 7443A(a), violates the Appointments Clause of the Constitution, Art. II, § 2, Cl. 2. Pet. App. A7-A9 & n.9, A11 n.11.

The court of appeals affirmed the Tax Court's decisions in all respects. It held that 26 U.S.C. 7443A(b)(4) authorized assignment of petitioners' cases to a special

[5] Appeals from the decisions entered in three of the other test cases were taken to the United States Courts of Appeals for the Fourth and Sixth Circuits. Those cases, however, were later settled.

trial judge for hearing and report, noting that the statute and the Tax Court's procedures require a regular judge of the Tax Court to "control[] the outcome of the case." Pet. App. A7 n.8. The court further held that by consenting to the assignment, petitioners waived any objection they might have raised under the Appointments Clause. *Id.* at A8 n.9. Given this conclusion, the court found it unnecessary to rule on the merits of petitioners' Appointments Clause challenge.

On the deductibility of petitioners' claimed tax shelter "losses," the court of appeals held that the Tax Court "could not help but" conclude that the First Western transaction were shams, Pet. App. A8, and that it was "ludicrous to suggest that these petitioners had anything but a most fleeting interest in a potential economic gain" with respect to those transactions, *id.* at A11 n.11. Accordingly, the court affirmed the disallowance of petitioners' deductions.

SUMMARY OF ARGUMENT

1. Assignment of petitioners' cases to a special trial judge is authorized by the unambiguous language of 26 U.S.C. 7443A. That Section authorizes the chief judge of the Tax Court to assign a special trial judge to hear *and* decide three categories of cases (declaratory judgment proceedings, small cases under 26 U.S.C. 7463, and other small cases), and to hear, but *not* decide, "any other proceeding" in the Tax Court. The legislative history confirms that Congress intended the statutory phrase "any other proceeding" in 26 U.S.C. 7443A(b)(4) to mean that "*any* other proceeding" may be assigned to a special trial judge for hearing and preparation of proposed findings and opinion. See 1 H.R. Rep. No. 432, 98th Cong., 1st Sess. 266 (1983).

This authority is not new, and it is not limited to cases that are "minor" or lack "wide-ranging effect." Pet. Br. 18, 23. Statutory authority to assign a special trial judge (or "commissioner" as they formerly were called) to hear (but not decide) any case within the jurisdiction of the Tax Court has existed since 1943. The chief judge frequently assigned large and complex cases to special trial judges on that authority before 1984. Consequently, when Congress adopted the "any other proceeding" provision in 1984, it codified special trial judges' authority to hear and report on any case within the Tax Court's jurisdiction.

2. Petitioners waived their right to challenge the special trial judge's appointment by giving their express consent to the chief judge's assignment of a special trial judge to hear and report on their cases. Application of the waiver rule in this case serves both to promote judicial economy and to prevent a party from waiting to raise objections that do not go to the merits until after he has lost his case on the merits.

Petitioners seek to avoid this basic rule by claiming that separation of powers challenges cannot be waived, and that this Court must therefore entertain their Appointments Clause claim despite their express consent below. This Court's prior decisions, however, have declined to enforce waivers only when the structural interests of the Article III Judiciary have been at stake. See *CFTC* v. *Schor*, 478 U.S. 833, 850-851 (1986); *Glidden Co.* v. *Zdanok*, 370 U.S. 530, 535-537 (1962); *Lamar* v. *United States*, 241 U.S. 103, 117-118 (1916). That is because litigants cannot be assumed to protect the institutional interests of the Judiciary. *Schor*, 478 U.S. at 850-851. That rationale is clearly inapplicable to petitioners' particular Appointments Clause challenge, which is based on a constitutional provision safeguarding the prerogatives of the Executive that the Executive can be expected to invoke and will be in a position to invoke in every tax case.

3. A. The duties performed by special trial judges assigned cases under 26 U.S.C. 7443A(b)(4) need not be performed by Officers of the United States. Like a special master assigned by an Article III court, a special

trial judge assigned under Section 7443A(b)(4) acts only as an aide to a judge of the Tax Court, who retains ultimate responsibility for making findings and entering the opinion and decision for the court. Unlike assignments under Section 7443A(b)(1)-(3)—where the special trial judge may be authorized to make the decision for the Tax Court—special trial judges in cases assigned under Section 7443A(b)(4) may only hear evidence and prepare proposed findings and opinions. Thus, the special trial judges in cases like these merely assist the judges of the Tax Court in discharging *their* ultimate responsibility to decide the cases. As assistants to Tax Court judges, special trial judges do not themselves exercise significant governmental authority and therefore are not "Officers of the United States" subject to the Appointments Clause.

B. If the duties performed by special trial judges in cases under 26 U.S.C. 7443A(b)(4) must be performed by Officers of the United States, their appointment by the chief judge satisfies the Appointments Clause. Special trial judges are at most "inferior" Officers of the United States, and, accordingly, Congress may vest power to appoint them "in the President alone, in the Courts of Law, or in the Heads of Departments." Art. II, § 2, Cl. 2. The answer to the question whether the Tax Court is included within the phrase "the Courts of Law" or the term "Departments," as those words are used in the Appointments Clause, turns on the status of the Tax Court within our tripartite system of separated powers. The Tax Court cannot exist in some headless fourth branch of government; it must be in the Legislative, Judicial, or Executive Branches established by the Constitution. Given its functions and the manner in which it discharges them, the Tax Court plainly cannot be in the Legislative Branch. See *INS* v. *Chadha*, 462 U.S. 919, 951 (1983). Given the Tax Court judges' lack of lifetime tenure and salary protection, the Tax Court plainly cannot be in the Judicial Branch. See U.S. Const. Art. III, § 1; *Glidden*, 370 U.S. at 552 (plurality opinion). It therefore resides in the Executive Branch.

For the 45 years prior to 1969, the Tax Court was expressly designated by Congress as an agency within the Executive Branch. Although Congress established the Tax Court as a "court of record" under "article I of the Constitution" in 1969, its function, and the manner in which it performs that function, did not change. Nothing in the terms of the 1969 legislation purported to remove the Tax Court from the Executive Branch or to incorporate it into either the Legislative or Judicial Branches. It therefore remains an Executive Branch agency. The chief judge, as the "Head[]" of the "Department[]" called the Tax Court, may constitutionally be vested with authority to appoint "inferior Officers" of the United States.

This conclusion is faithful to the important constitutional purpose served by the Appointments Clause. That Clause—together with the Incompatibility Clause, Art. I, § 6, Cl. 2—embodies the basic departure of the Framers from the British Parliamentary system. The Appointments Clause ensures that the Legislative Branch will not intrude on executive or judicial functions by affecting the appointments process, beyond the constitutional role of advice and consent. Under the Clause, appointment authority can be vested by Congress only in the other two Branches, each of which possesses constitutional powers and prerogatives sufficient to withstand congressional efforts to affect particular appointments. Thus, "the Courts of Law" are limited to the Article III Judiciary (and do not include the Tax Court), because the Article III Judiciary can rely on life tenure and salary protection to resist legislative encroachment. And "Departments" is limited to Executive Branch Departments, protected from such encroachment by the various constitutional powers of the Chief Executive. Were the Tax Court not in the Executive Branch and therefore outside the scope of those protections, it would

be subject to precisely the sort of congressional interference in the appointments process that the Appointments Clause was designed to forestall. Because it is an Executive Branch Department, however, its "Head[]" may be vested with appointment authority under the terms of that Clause.

ARGUMENT

I. 26 U.S.C. 7443A(b)(4) AUTHORIZED THE CHIEF JUDGE OF THE TAX COURT TO ASSIGN PETITIONERS' CASES TO A SPECIAL TRIAL JUDGE

A. Section 7443A(b) of the Internal Revenue Code (26 U.S.C.) authorizes the chief judge of the Tax Court to assign four categories of cases to special trial judges: (1) "any declaratory judgment proceeding," 26 U.S.C. 7443A(b)(1); (2) "any proceeding" under 26 U.S.C. 7463 (whose informal procedures are available at the taxpayer's election in cases involving less than $10,000), 26 U.S.C. 7443A(b)(2); (3) "any proceeding" in which the deficiency or claimed overpayment does not exceed $10,000, 26 U.S.C. 7443A(b)(3); and (4) "any other proceeding which the chief judge may designate," 26 U.S.C. 7443A(b)(4). In the first three categories, the chief judge may assign the special trial judge not only to hear and report on a case but also to decide it. 26 U.S.C. 7443A(c). In the fourth category, the chief judge may only authorize the special trial judge to hear the case and prepare a report. The case must be decided by a regular judge of the Tax Court. 26 U.S.C. 7443A(c).

The chief judge's assignment of petitioners' cases to a special trial judge is authorized by the plain language of 26 U.S.C. 7443A(b)(4). Petitioners acknowledge as much; their objection is that "[t]he court of appeals read this language literally." Pet. Br. 12. Subsection (b)(4) permits the chief judge to assign "any other proceeding" (than the ones listed in subsections (1) through (3)) "to be heard by the special trial judges of the court." Subsection (b)(4) is unambiguous. Its text contains no limiting term of the sort petitioners would imply that restricts its reach to cases that are "minor" or lack "wide-ranging effect." Pet. Br. 18, 23. See *Business Guides, Inc.* v. *Chromatic Communications Enters., Inc.*, 111 S. Ct. 922, 928 (1991) ("[O]ur inquiry is complete if we find the text * * * to be clear and unambiguous."); *Pavelic & LeFlore* v. *Marvel Entertainment Group*, 110 S. Ct. 456, 460 (1989) ("Our task is to apply the text, not to improve it."); *Hallstrom* v. *Tillamook County*, 110 S. Ct. 304, 309 (1989) (Courts "are not at liberty to create an exception where Congress has declined to do so.").

The legislative history confirms that the statutory text means what it says, and that the chief judge may assign "*any* other proceeding" within the Tax Court's jurisdiction to special trial judges. In proposing to amend former 26 U.S.C. 7456(d) (now Section 7443A) to provide expressly for this category of assignments, the House Report stated that its purpose was "to clarify" that any other proceeding could be assigned to special trial judges "so long as a Tax Court judge must enter the decision." 1 H.R. Rep. No. 432, 98th Cong., 1st Sess. 266 (1983). The House Report explains:

> A technical change is made to allow the Chief Judge of the Tax Court to assign *any* proceeding to a special trial judge *for hearing and to write proposed opinions*, subject to review and final decision by a Tax Court judge, *regardless of the amount in issue*. However, special trial judges will not be authorized to enter decisions in this latter category of cases.

Ibid. (emphasis added). The Conference Report "follows the House bill." H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. 1127 (1984).

B. The 1984 amendment was regarded as "technical" in light of the historical development of the special trial judges' role. As we describe in detail below, that history demonstrates that Congress has *never* restricted the chief

judge's authority to assign special trial judges to hear (but not decide) cases to any particular subset of the Tax Court's jurisdiction. To the contrary, special trial judges and their predecessors—known as commissioners—have been authorized for almost half a century to hear *any* cases before the Tax Court in the discretion of its chief judge. In practice, special trial judges frequently heard and reported on large and complex cases before 1984. Accordingly, when Congress adopted subsection (b)(4) in 1984, it codified the chief judge's discretion to assign cases just like petitioners' to a special trial judge for hearing and preparation of a report. See, *e.g.*, *Midlantic Nat'l Bank* v. *New Jersey Dep't of Envtl. Protection*, 474 U.S. 494, 501 (1986) ("[T]he normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific.").

In contrast, Congress has limited the authority of special trial judges to enter decisions to narrow categories of cases from the origin of that power in 1974. Congress's expansion of special trial judge's authority to hear *and decide* cases may well have been "measured [and] incremental." Pet. Br. 19-20. The accuracy of that observation, however, has no bearing on the scope of cases that special trial judges can hear but *not decide*. The authority in that category of cases has not changed since 1943.

Congress first conferred authority to employ what we now call special trial judges when it authorized the chief judge of the Tax Court "from time to time by written order [to] designate an attorney from the legal staff of the court to act as a commissioner in a particular case * * * [to] proceed under such rules and regulations as may be promulgated by the Tax Court." Section 1114 of the Internal Revenue Code of 1939, as amended by Section 503 of the Revenue Act of 1943, ch. 63, 58 Stat. 72; see H.R. Rep. No. 871, 78th Cong., 1st Sess. 71-72 (1943). The statute did not restrict the types of proceedings in which commissioners could be used.[6] That authority was continued, without substantial change, in Section 7456(c) of the 1954 Code, as originally enacted. In 1969, Congress amended that provision to provide for appointment of full-time commissioners, serving for indefinite terms, who were to "proceed under such rules and regulations as may be promulgated by the court." Section 7456(c), amended by Tax Reform Act of 1969, Pub. L. No. 91-172, § 958, 83 Stat. 734. Section 502(a)(2)(A) of the 1969 Act (83 Stat. 630) also created an elective, streamlined procedure for small tax cases,[7] but it did not restrict the use of commissioners to such cases.

More than 30 years after commissioners were authorized to hear and report on cases pending before the Tax Court, Congress for the first time authorized the Tax Court to permit commissioners to decide a case. In 1974, Congress enacted provisions permitting the maintenance of declaratory judgment actions in cases relating to the qualification of certain retirement plans, and authorized the chief judge of the Tax Court, in his discretion, to permit commissioners to hear and make the decisions of the court in such cases. Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, § 1041(a), 88

[6] Commissioners were apparently "used sparingly" at first. H. Dubroff, *The United States Tax Court: An Historical Analysis* 346 (1979). The first reported designation of a "commissioner" occurred in 1948. The commissioner was assigned to hear the evidence and make recommended findings of fact, but not to propose conclusions of law. *Bib Mfg. Co.* v. *Secretary of War*, 12 T.C. 665, 672 (1949).

[7] The elective small case procedure originally applied only to cases involving disputed issues of no more than $1,000, an amount increased to $1,500 in 1972, Act of Oct. 20, 1972, Pub. L. No. 92-512, § 203(b)(2), 86 Stat. 945, to $5,000 in 1978, Revenue Act of 1978, Pub. L. No. 95-600, § 502(a)(1), 92 Stat. 2879 and to $10,000 in 1984, Tax Reform Act of 1984, Pub. L. No. 98-369, § 461, 98 Stat. 823. Proceedings in such cases may be conducted informally, and the decisions entered in them are not appealable by either party. 26 U.S.C. 7463.

Stat. 949 (codified at 26 U.S.C. 7456(c)). In 1978, Congress amended 26 U.S.C. 7456(c) to expand the Tax Court's authority to allow commissioners to make decisions in declaratory judgment proceedings, and added 26 U.S.C. 7463(g), providing the same authority in the case of small tax proceedings under that Section. Revenue Act of 1978, Pub. L. No. 95-600, §§ 336(b)(1), 502(b), 92 Stat. 2841-2842, 2879. After further expansion, the provisions allowing entry of decision by commissioners were redesignated in 1982 as 26 U.S.C. 7456(d), and encompassed all three categories now set forth in 26 U.S.C. 7443A(b)(1)-(3). Miscellaneous Revenue Act of 1982, Pub. L. No. 97-362, § 106(c)(1), 96 Stat. 1730.

While Congress was expanding the authority of commissioners to hear and decide cases, their employment in the traditional task of hearing cases had expanded dramatically. Chief judges assigned commissioners to hear the full spectrum of Tax Court cases, including complex cases and cases involving lengthy trials.[8] The provisions governing the assignment of special trial judges took essentially their present form in 1984, when Congress changed the term "commissioner" to "special trial judge" and added to 26 U.S.C. 7456(d) the provision corresponding to present 26 U.S.C. 7443A(b)(4). Tax Reform Act of 1984, Pub. L. No. 98-369, § 463(a), 98 Stat. 824. In 1986, the provisions of former Section 7456(c) and (d) were moved, without substantial change, to new Section 7443A. Tax Reform Act of 1986, Pub. L. No. 99-514, § 1556(a), 100 Stat. 2754. By providing that

[8] See, *e.g.*, *Perrett* v. *Commissioner*, 74 T.C. 111 (1980); *Karme* v. *Commissioner*, 73 T.C. 1163 (1980), aff'd, 673 F.2d 1062 (9th Cir. 1982); *Jacqueline, Inc.* v. *Commissioner*, 36 T.C.M. (CCH) 1363 (1977); *Estate of Wheeler* v. *Commissioner*, 37 T.C.M. (CCH) 51 (1978); *Estate of Thurner* v. *Commissioner*, 37 T.C.M. (CCH) 981 (1978); *McKinley* v. *Commissioner*, 37 T.C.M. (CCH) 1769 (1978); *Freidus* v. *Commissioner*, 39 T.C.M. (CCH) 740 (1979). See generally 2A L. Casey, *Federal Tax Practice* § 8.34, at 275 (1981) (the assignments of special trial judges, *i.e.*, commissioners, covered a "broad range," including "the trial of lengthy cases").

special trial judges could hear and decide three different categories of cases, and could hear (but not decide) "any other proceeding," Congress codified the chief judge's longstanding authority to assign any case within the Tax Court's jurisdiction to a special trial judge for hearing and report.

C. Petitioners contend that "the 'any other proceeding' language of 26 U.S.C. 7443A(b)(4) must be read in light of the narrow grants of jurisdiction in §§ (b)(1)-(3)." Pet. Br. 17. They suggest that subsection (b)(4) is a "catch-all" provision, Pet. Br. 17, 22, embracing the same type of cases as the declaratory judgment proceedings and small tax cases described in the first three subsections; on that view, subsection (b)(4) does not authorize assignment to a special trial judge of large or complex cases like theirs. Pet. Br. 17-20.

Subsection (b)(4), however, is clearly not a "catch-all" designed to plug unintended gaps left by subsections (b)(1) through (b)(3). As the very next subsection makes clear, special trial judges can hear *and decide* declaratory judgment proceedings and small tax cases under subsections (b)(1) through (b)(3); they can hear but may *not decide* proceedings under subsection (b)(4). 26 U.S.C. 7443A(c). The lesser authority special trial judges exercise in proceedings under subsection (b)(4) prevents that provision from serving as a "catch-all" for subsections (b)(1) through (b)(3). It also furnishes additional evidence that the scope of subsection (b)(4) must be greater than that of subsections (b)(1) through (b)(3): for if the cases special trial judges can hear (but *not* decide) under subsection (b)(4) are limited to declaratory judgment actions and small cases of the sort they could hear *and* decide under subsections (b)(1) through (b)(3), subsection (b)(4) would be superfluous. See, *e.g.*, *Pennsylvania Dep't of Public Welfare* v. *Davenport*, 110 S. Ct. 2126, 2133 (1990) ("Our cases express a deep reluctance to interpret a statutory provision so as to

render superfluous other provisions in the same enactment.").

Petitioners' misunderstanding of the function of subsection (b)(4) renders inapposite their analogy to *Gomez* v. *United States*, 490 U.S. 858 (1989). Pet. Br. 17-22. *Gomez* involved the question whether Section 636(b) of the Federal Magistrates Act (28 U.S.C. 636(b)) authorized a district court to assign a magistrate to preside over jury selection in a criminal felony trial without the defendant's consent. Although the statutory language allowing assignment to a magistrate of "such additional duties as are not inconsistent with the Constitution and laws of the United States" is broad, this Court reasoned that presiding over jury selection was unrelated to the carefully defined grant of authority to conduct trials of civil matters and minor criminal cases and was at odds with the "repeated statements" in the legislative history that magistrates should only "handle subsidiary matters to enable district judges to concentrate on trying cases." 490 U.S. at 872. Moreover, the Court remarked, there could be no meaningful review and correction of jury selection by the district court. Consequently, the Court concluded that Congress could not have intended for the "additional duties" clause to include presiding over jury selection in felony trials. *Id.* at 874-876.

Unlike the "catch-all" provision at issue in *Gomez*, subsection (b)(4) does not extend special trial judges' authority to hear *and decide* cases under subsections (b)(1) through (b)(3) to any case within the Tax Court's jurisdiction. A special trial judge assigned pursuant to subsection (b)(4) may only hear a case and prepare proposed factual findings and legal conclusions; a regular Tax Court judge remains responsible for deciding the case. 26 U.S.C. 7443A(c). Precisely because the special trial judge's authority under subsection (b)(4) is less than that under subsections (b)(1) through (b)(3), it extends to "any other proceeding" before the

Tax Court, regardless of the amount involved or the nature of the controversy.

D. Petitioners contend that "[e]ven if a special trial judge may hear a complex tax case, he may not effectively resolve it subject only to deferential Tax Court review." Pet. Br. 20. The relevance of this point to the question on which this Court granted certiorari—whether the assignment of petitioners' cases to a special trial judge is authorized by 26 U.S.C. 7443A(b)(4), see Pet. Br. i—is not immediately apparent. The question whether the assignment is permitted is different from the question of the appropriate standard of review once the assignment is made. The court of appeals properly rejected petitioners' assertion that Chief Judge Sterrett "rubber-stamp[ed]" the special trial judge's report, Pet. Br. 24, and petitioners did not seek review of that claim, see Br. in Opp. 7 n.6.

In any event, petitioners are quite correct that special trial judges may not decide cases assigned to them under 26 U.S.C. 7443A(b)(4), and are quite wrong in suggesting that a deferential standard of review allows them in effect to do so. Pet. Br. 6-7, 13, 21-23. By statute, a special trial judge has no authority to decide a case assigned under that provision; that remains the responsibility of a regular Tax Court judge. 26 U.S.C. 7443A(c); see Pet. App. A7 ("The chief judge had both the obligation and power to maintain full responsibility for the decision in this case."). As petitioners (correctly) stated in the court of appeals, they "are entitled to a careful *de novo* review of the findings of a special trial judge by a tax court judge because the special trial judge cannot make the decision in a case assigned to him under § 7443A(b)(4)." Pet. C.A. Reply Br. 3 (footnote omitted); *id.* at 3 n.5 ("The responsibility for evaluating the evidence is placed upon the tax court judge who reviews the proposed report of the special trial judge."); accord Pet Br. 43 n.42 (petitioners anticipated "*de novo* review

* * * when they accepted the mid-trial reassignment to Judge Powell").[9]

Reversing field in this Court, petitioners now insist that *de novo* review is forbidden by Tax Ct. R. 183. Pet. Br. 6-7, 21. Contrary to petitioners' contention, Rule 183

[9] The record in no way supports the contention that the special trial judge in effect decided petitioners' cases. As the court of appeals explained in rejecting this assertion, "the opinion in this case was issued by the Tax Court in the name of the chief judge," who "had both the obligation and power" to decide the case. The court of appeals found the "record * * * devoid of any evidence that even remotely suggest[ed]" that the chief judge failed to discharge his obligation "in good faith," other than what it surmised was a short time span between the filing of the special trial judge's report and issuance of the opinion by the chief judge. Pet. App. A7-A8.

On the last point, the court of appeals apparently credited petitioners' claim that the special trial judge filed his report on the same day Chief Judge Sterrett issued his opinion. Pet. App. A8. Nothing in the record supports that assertion. The Tax Court's docket entries and order on which petitioners rely, Pet. Br. 8, indicate that the case was formally reassigned to Chief Judge Sterrett "for disposition" on October 21, 1987, prior to his entry of decision on that day. J.A. 6, 15. They do *not* reflect the date on which the special trial judge's report was submitted to Chief Judge Sterrett. *Ibid.* Indeed, the Tax Court's practice is formally to reassign cases heard by special trial judges to regular Tax Court judges only when the latter are ready to enter decisions in the cases. See, *e.g.*, *Abeson* v. *Commissioner*, 59 T.C.M. (CCH) 391 (1990) (Docket Nos. 82 & 83), appeal pending on other grounds, No. 91-70086 (9th Cir.); *Corra Resources, Ltd.* v. *Commissioner*, 59 T.C.M. (CCH) 102 (1990) (Docket Nos. 28 & 29), appeal pending on other grounds, No. 90-3365 (7th Cir.); *Hildebrand* v. *Commissioner*, 58 T.C.M. (CCH) 1470 (1990) (Docket Nos. 20 & 21), appeal pending on other grounds, No. 91-70030 (9th Cir.). For that reason, the date on which the chief judge reassigned petitioners' cases to himself "for disposition" tells nothing about how long the chief judge had the report or worked on the cases prior to deciding them. Yet the docket entries and order are all that petitioners point to in support of their charge that the chief judge acted—contrary to 26 U.S.C. 7443A(c)—as a "rubber stamp." Pet. Br. 24. See *FCC* v. *Schreiber*, 381 U.S. 279, 296 (1965) (administrative agencies are entitled to presumption "that they will act properly and according to law").

does not limit Tax Court judges to "clear error" review of special trial judges' reports. Rule 183 provides that the Tax Court judge responsible for deciding a case may adopt, modify, or reject the special trial judge's report in whole or in part, may request additional briefing, and "may receive further evidence"—an authority that is flatly inconsistent with "clear error" review, under which an appellate tribunal reviews the adequacy of findings on the basis of the record before the fact-finder. See *Anderson* v. *City of Bessemer City*, 470 U.S. 564, 573-574 (1985). Petitioners rely entirely on the last sentence in the Rule, which states that "[d]ue regard" shall be given to special trial judges' credibility determinations and that "findings of fact recommended by the Special Trial Judge shall be presumed to be correct." Pet. Br. 6-7, 13, 21-23. Although the phrasing of this sentence is not ideal, it does not limit the regular Tax Court judge deciding the case to "clear error" review, and has not been so understood by the Tax Court. Instead, the Rule requires the regular judge to start with the facts found by the special trial judge before considering the parties' proposed findings of "essential fact" under Tax Ct. R. 151(e)(3). As the court of appeals correctly concluded, the Tax Court judge to whom the case is assigned "controls the outcome of the case," notwithstanding the presumption of correctness. Pet. App. A7 n.8.[10]

[10] The court of appeals also rejected petitioners' argument that *Stone* v. *Commissioner*, 865 F.2d 342, 344-347 (D.C. Cir. 1989), reversing *Rosenbaum* v. *Commissioner*, 45 T.C.M. (CCH) 825 (1983), limits Tax Court judges to "clear error" review of special trial judges' proposed factual findings. Pet. App. A8 n.8. Although *Stone* so held, see 865 F.2d at 345, the Tax Court has never retreated from the position it took in *Rosenbaum* that "the presumptive correctness of the Special Trial Judge's report does not impair nor dilute our duty of bearing the ultimate responsibility for determining matters before us." *Rosenbaum*, 45 T.C.M. (CCH) at 827. In accordance with that position, the Tax Court no longer furnishes litigants a copy of the special trial judge's report, nor does it invite the parties to file exceptions to the report. *Ibid.*;

Petitioners invoke the canon of statutory construction that presumes Congress intended to enact a constitutional statute in their effort to limit the "any other proceeding" language of 26 U.S.C. 7443A(b)(4) to small cases. Pet. Br. 14-17. A preference for giving statutes a constitutional meaning, however, is a finger on otherwise balanced scales at the end of the process of interpretation, not at the beginning. It is emphatically "not a license for the judiciary to rewrite language enacted by the legislature." *United States* v. *Monsanto*, 109 S. Ct. 2657, 2664 (1989) (quoting *United States* v. *Albertini*, 472 U.S. 675, 680 (1985)). Petitioners' interpretation of subsection (b)(4) to mean "any other [small] proceeding" would require this Court to override the plain language of the statute, its structure, and the pre-codification history of special trial judges hearing cases selected from the full cross-section of the Tax Court's jurisdiction. Canons of construction like the one petitioners invoke are useful only when language is ambiguous and "a construction of the statute is *fairly possible* by which the question may be avoided." *Crowell* v. *Benson*, 285 U.S. 22, 62 (1932) (emphasis added). It is not authority to hold that a statute means what it plainly does not say. *CFTC* v. *Schor*, 478 U.S. 833, 841 (1986); *Aptheker* v. *Secretary of State*, 378 U.S. 500, 515 (1964).

Pet. App. A8 n.8. As the court of appeals concluded, "this change in rules, in our view, confirms that the Tax Court's relationship with its special trial judges cannot be analogized to typical appellate review." *Ibid.* No court has held to the contrary since the change in the Tax Court's practice.

Petitioners (Pet. Br. 23) quote the court of appeals' statement that whether a particular transaction is a sham "is a question of fact reviewed under the clearly erroneous standard," Pet. App. A8, but the court of appeals was referring to *its* review of the *Tax Court's* determination, not the regular Tax Court judge's review of the special trial judge's report.

II. PETITIONERS WAIVED ANY RIGHT TO CHALLENGE THE APPOINTMENT OF THE SPECIAL TRIAL JUDGE IN THEIR CASE BY CONSENTING TO HAVE THEIR CASES HEARD BY THE SPECIAL TRIAL JUDGE

Petitioners not only failed to raise a timely objection to assignment of their cases to a special trial judge, they expressly consented to the assignment. As the court of appeals correctly held, "[b]y consenting to the assignment * * * [petitioners] waived" any right to challenge the special trial judge's appointment under the Appointments Clause, Art. II, § 2, Cl. 2. Pet. App. A8 n.9.[11]

A. This Court has emphasized that "[n]o procedural principle is more familiar to [the] Court than that a * * * right may be forfeited in criminal as well as civil cases by failure to make timely assertion of the right before a tribunal having jurisdiction to determine it." *Yakus* v. *United States*, 321 U.S. 414, 444 (1944); accord *United States* v. *Socony-Vacuum Oil Co.*, 310 U.S. 150, 238-239 (1940); *Blair* v. *Oesterlein Mach. Co.*, 275 U.S. 220, 225 (1927) ("There are specially cogent reasons why this rule should be adhered to when the question involves a practice of one of the great departments of the government."). Requiring timely assertion of an objection serves two important purposes: it promotes judicial economy by alerting the lower court to a problem at a time

---

[11] Petitioners' express consent distinguishes this case from *Gomez*, in which the defendant objected to permitting a magistrate to conduct jury selection, and from *United States* v. *France*, 886 F.2d 223 (9th Cir. 1989), aff'd without opinion by equally divided court, 111 S. Ct. 805 (1991), in which the court of appeals entertained the challenged of a litigant who failed to object to the same action.

On the same day the Court granted certiorari in this case, the Court also granted certiorari in *Peretz* v. *United States*, No. 90-615 (Jan. 22, 1991). *Peretz* presents the question whether express consent to assignment of a magistrate for jury selection waives any right to challenge the assignment on the authority of this Court's subsequent decision in *Gomez*.

when the court may be able to resolve the matter to the party's satisfaction, see *Wainwright* v. *Sykes*, 433 U.S. 72, 90 (1977); and it prevents a party from pursuing a certain course at trial for tactical reasons and later—if the outcome is unfavorable—claiming that the course followed constituted reversible error, see *id.* at 89.

Petitioners' conduct in this case falls squarely within the letter and spirit of this Court's settled practice of requiring contemporaneous objections. But petitioners did not just commit a procedural default in the Tax Court; they expressly consented to the assignment of a special trial judge to hear and report on their cases with full knowledge of the consequences of their decision.[12] Petitioners' consent led the Tax Court to assign special trial judge Powell to hear and report on their cases, rather than another judge, as was ordered in the case of the one litigant who *did* object to the assignment. J.A. 4-6. If petitioners are permitted to withdraw their consent now, many months of trial time will have been wasted. What is worse, petitioners will have been permitted to withdraw their consent and assert reversible error not just after the trial, but after they learned that the supposed error did not work to their benefit.

This Court should not be moved by petitioners' crocodile tears that their consent was involuntary. Pet. Br. 49-50. Consent to the special trial judge's preparation of a re-

[12] The chief judge notified petitioners of his proposal to assign their cases to special trial judge Powell "for purposes of preparing the report," J.A. 8, and invited petitioners' objection (if any) to the assignment, J.A. 9. Petitioners—represented by counsel—discussed with the chief judge the options available to them and the terms on which they would consent to the assignment, J.A. 10-11, and ultimately entered a formal stipulation to the assignment, J.A. 13. Whether the Tax Court's procedures are sufficient to ensure knowing and voluntary consent in *other* cases, Pet. Br. 47-48, is irrelevant to petitioners' claim in this one: *their* consent was knowing and voluntary, and outside the First Amendment context parties may assert only their own rights, not those of others. *E.g.*, *Powers* v. *Ohio*, No. 89-5011 (Apr. 1, 1991), slip op. 10; *Singleton* v. *Wulff*, 428 U.S. 106, 114 (1976).

port in petitioners' cases was not a "compelled alternative" to retrial before a regular Tax Court judge. *Pacemaker Diagnostic Clinic of America* v. *Instromedix, Inc.*, 725 F.2d 537, 543 (9th Cir.) (en banc), cert. denied, 469 U.S. 824 (1984); cf. *CFTC* v. *Schor*, 478 U.S. 833, 850 (1986) (offer of "quicker and less expensive" adjudication does not necessarily coerce consent). Semble *Arizona* v. *Fulminante*, No. 89-839 (Mar. 26, 1991), slip op. 4. Conclusive proof is that the relief petitioners seek in this Court—"a remand for trial before a regular tax court judge," Pet. Br. 37—is precisely the prospect that petitioners insist forced their consent in 1986. The options available to petitioners (consent to the special trial judge's preparation of the report or retrial before a regular Tax Court judge) have not changed since that time. What is new is that petitioners now know that they lose under the option they initially preferred. If an Appointments Clause challenge can ever be waived, petitioners should be held to have waived it here.

B. Petitioners contend that the court of appeals was required to entertain their belated Appointments Clause challenge because separation of powers claims may never be waived. Pet. Br. 43-46.[13] The cases on which petitioners rely for this sweeping proposition—*CFTC* v. *Schor*, 478 U.S. 833 (1986), *Glidden Co.* v. *Zdanok*, 370 U.S. 530 (1962), and *Lamar* v. *United States*, 241 U.S. 103 (1916), Pet. Br. 41-47—hold only that litigants may not waive the structural limitations *of Article III*, because that Article serves "institutional interests that the parties cannot be expected to protect," *Schor*, 478 U.S. at 850-851. The rationale of those cases has no necessary application to separation of powers claims not involving the Judiciary; it is clearly inapplicable to petitioners' par-

[13] Although challenges to an Article III court's subject matter jurisdiction are not waivable, the Tax Court is not an Article III court, and, in any event, petitioners "do not claim that Tax Court special trial judges lack subject matter jurisdiction." Reply to Br. in Opp. 3.

ticular challenge, which is based on a constitutional provision safeguarding the prerogatives of the Executive that the Executive can be expected to invoke and—in tax cases—will always be in a position to invoke. The Constitution separates the executive, legislative, and judicial powers precisely because the great departments can be trusted to protect their own institutional interests. See, *e.g.*, The Federalist No. 51, at 349 (J. Madison) (J. Cooke ed. 1961) ("[T]he great security against a gradual concentration of the several powers in the same department, consists in giving to those who administer each department, the necessary constitutional means, and personal motives, to resist encroachments of the others."). Exceptions to the general rule of waivability should be reserved for situations where litigants cannot be relied on to protect the institutional interests at stake, not where we know they can.

1. In *Schor*, this Court held that parties may waive their personal right to adjudication by an Article III court, 478 U.S. at 848-850, but "[t]o the extent that this structural principle [*i.e.*, of Article III] is implicated in a given case, * * * notions of consent and waiver cannot be dispositive because the limitations serve institutional interests that the parties cannot be expected to protect," *id.* a 850-851.[14] *Schor* involved the assertion of jurisdiction by the Commodity Futures Trading Commission, a non-Article III forum, over a common law counterclaim —"a claim of the kind assumed to be at the 'core' of matters normally reserved to Article III courts." *Id.* at 853. Hence, the institutional interest at stake was the "institutional integrity of the Judicial Branch," *id.* at 851—an

[14] Petitioners' edited quotation of the holding in *Schor*, Pet. Br. 44, begins after the Court's reference to "*this* structural principle," which refers to Article III, 478 U.S. at 850 (emphasis added), and omits the first clause of the next sentence, which states that "[w]hen *these Article III limitations are at issue*, notions of consent and waiver cannot be dispositive because the limitations serve institutional interests that the parties cannot be expected to protect," *id.* at 851 (emphasis added).

interest that parties content to have their dispute resolved by the CFTC might (at least initially) have no interest in protecting.

Unlike the situation in *Schor*, the assignment of special trial judges in Tax Court cases does not raise the specter of "a phalanx of non-Article III tribunals equipped to handle the entire business of the Article III courts," 478 U.S. at 855. Tax controversies are not matters of private right "normally reserved to Article III courts," *id.* at 853. As petitioners concede, Pet. Br. 20 n.21, 35, tax disputes are "matters, involving public rights, * * * which Congress may or may not bring within the cognizance of the courts of the United States, as it may deem proper," *Murray's Lessee* v. *Hoboken Land & Improvement Co.*, 59 U.S. (18 How.) 272, 284 (1856). The need to enforce "Article III limitations" that prompted the Court to dishonor the express consent in *Schor* thus has no application to this case.[15]

Glidden and *Lamar*, on which petitioners also rely, Pet. Br. 41-43, likewise involved challenges premised on Article III. The validity of the judgments in those cases arguably turned on the authority of the judges who entered them (or participated in entering them). See *Glidden*, 370 U.S. at 535-537 (plurality opinion); *Lamar*, 241 U.S. at 117-118.[16] Justice Harlan's explanation why the plurality

[15] *Pacemaker Diagnostic Clinic of America* v. *Instromedix, Inc.*, 725 F.2d 537 (9th Cir.) (en banc), cert. denied, 469 U.S. 824 (1984), is distinguishable for the same reason. At issue in that case was the consensual assignment of a case to a magistrate for adjudication. Thus, the case presented essentially the same question as in *Schor*—whether an official who did not enjoy the life tenure and salary protection guaranteed to the Article III Judiciary could properly adjudicate the claims in question.

[16] See also *Burnham* v. *Superior Court*, 110 S. Ct. 2105, 2109 (1990) (plurality opinion) ("The proposition that the judgment of a court lacking jurisdiction is void traces back to the English Year Books, * * *. Traditionally that proposition was embodied in the phrase *coram non judice*, 'before a person not a judge'—meaning, in effect, that the proceeding in question was not a *judicial* proceed-

would ignore the waiver in those cases rests entirely on structural limitations imposed by Article III and the prerogatives of the Judicial Branch.[17]

2. *Schor*, *Glidden*, and *Lamar* all involved "institutional interests that the parties cannot be expected to protect." 478 U.S. at 851. The concern in those cases was that if Article III objections could be waived by the parties, the Judiciary might be incapable of protecting its constitutional prerogatives. The Judicial Branch exercises power only through the decision of "Cases [and] Controversies," U.S. Const. Art. III, § 2, and if enforcement of waiver rules precluded it from protecting its institutional interests in the context of deciding such cases, those interests would go unprotected. That rationale does not extend to every separation of powers challenge, and has no application to the Appointments Clause challenge raised by petitioners in this case.

---

ing because lawful judicial authority was not present, and could therefore not yield a *judgment*.").

[17] Whatever may be the rule when *a judge's authority* is challenged at the earliest practicable moment * * *, in other circumstances involving *judicial authority* this Court has described it as well settled "that where there is an office to be filled and one acting under color of authority fills the office and discharges its duties, his actions are those of an officer *de facto* and binding upon the public." The rule is founded upon an obviously sound policy of preventing litigants from abiding the outcome of a lawsuit and then overturning it if adverse upon a technicality of which they were previously aware. * * *

The rule does not obtain, of course, when the alleged defect of authority operates as a limitation on this Court's *appellate jurisdiction*. In other circumstances as well, when the statute claimed to restrict authority is not merely technical but embodies a strong policy concerning the proper administration of *judicial business*, this Court has treated the alleged defect as "*jurisdictional*" and agreed to consider it on direct review even though not raised at the earliest practicable opportunity.

370 U.S. at 535-536 (emphases added; citations omitted); see *id.* at 536 (discussing *Lamar*).

5

Together with the Incompatibility Clause, Art. I, § 6, Cl. 2,[18] the Appointments Clause reflects the Framers' rejection of the cardinal feature of parliamentary systems, in which members of the legislature serve as and appoint executive officers. The structural interests implicated in *this* case are thus those of the President and the Executive Branch itself, which can be expected vigorously to challenge legislative encroachments on presidential prerogatives under that Clause.[19] Unlike the Article III limitations at issue in *Schor*, *Glidden*, and *Lamar*, the Appointments Clause embodies an interest that at least one of the parties to every tax dispute (the Executive) can be expected to protect.[20] In Appointments Clause cases the institutional interests at stake are those of the Executive, and in tax cases the Executive will always be able to defend those interests. Accordingly, there is no reason, as there was in the Article III cases, for rescuing petitioners from the choice they made when they consented to allow the trial to proceed in accordance with statutory procedures.

Indeed, "[t]he Court [has] developed, for its own governance in the cases confessedly within its jurisdiction,

---

[18] Art. I, § 6, Cl. 2 ("[N]o Person holding any Office under the United States, shall be a Member of either House during his Continuance in Office.").

[19] Contrary to petitioners' suggestion, this case does not implicate any prerogative of the Judiciary to appoint inferior Officers as a "Court[] of Law" under the Appointments Clause. Pet. Br. 46 n.46. There is no question that the Tax Court is not an Article III court. Even more clearly, the chief judge of that court, in whom 26 U.S.C. 7443A(a) vests the power of appointing special trial judges, is not an Article III court.

[20] In listing cases in which the Justice Department failed, in petitioners' view, to defend adequately the interests of the Executive Branch, Pet. Br. 46 n.47, petitioners fail to mention that the Solicitor General argued against the constitutionality of the legislation in *Morrison* v. *Olson*, 487 U.S. 654, 659 (1988), *Bowsher* v. *Synar*, 478 U.S. 714, 716 (1986), and *INS* v. *Chadha*, 462 U.S. 919, 922 (1983).

[the rule that] * * * [t]he Court will not pass upon a constitutional question although properly presented by the record, if there is also present some other ground upon which the case may be disposed of." *Ashwander* v. *TVA*, 297 U.S. 288, 346-347 (1936) (Brandeis, J., concurring). That prudential rule applies with even greater force where, as here, the question is *not* properly presented.

III. THE TAX COURT CHIEF JUDGE'S APPOINTMENT OF THE SPECIAL TRIAL JUDGE WHO HEARD PETITIONERS' CASES DID NOT VIOLATE THE APPOINTMENTS CLAUSE

A. A Special Trial Judge Assigned Under 26 U.S.C. 7443A(b)(4) Performs Duties That May Be Performed By An Employee Not Subject To The Appointments Clause

Petitioners' contention that the special trial judge assigned to their cases performed duties that can only be performed by an Officer subject to the Appointments Clause must fail if special trial judges do not effectively decide cases under 26 U.S.C. 7443A(b)(4).[21] For it is well settled that persons who merely assist Officers in discharging their duties, and whose authority is not significant under the laws of the United States, are "lesser functionaries subordinate to officers of the United States." *Buckley* v. *Valeo*, 424 U.S. 1, 126 n.162 (1976) (per curiam); *United States* v. *Smith*, 124 U.S. 525, 531-532 (1888).[22]

---

[21] Petitioners seem to concede as much, when they argue that they had no occasion to raise their Appointments Clause challenge until the Tax Court—in their view—"denied the *de novo* review they anticipated when they accepted the mid-trial reassignment to Judge Powell." Pet. Br. 43 n.42.

[22] See *Steele* v. *United States No. 2*, 267 U.S. 505, 508 (1925) ("The deputy marshal is not in the constitutional sense an officer of the United States, and yet marshals and deputy marshals are the

A special trial judge assigned under 26 U.S.C. 7443A(b)(4) acts only as an aide to the Tax Court judge responsible for deciding the case. 26 U.S.C. 7443A(c). That judge may adopt, modify, or reject entirely the report of the special trial judge. Tax Ct. R. 183(c). Alternatively, he may request additional briefs, receive further evidence, direct further oral argument, or recommit the report to the special trial judge with instructions. *Ibid.* The special trial judge's role is only to assist the judge in taking the evidence and preparing proposed findings and an opinion. In other words, the special trial judge merely helps the Tax Court judges discharge the responsibilities of *their* offices.[23] Cf. *Morgan* v. *United States*, 298 U.S. 468, 481-482 (1936). The fact that staff attorneys acted as special trial judges from 1943 until 1969, see pp. 12-13, *supra*, is convincing evidence that special trial judges acting pursuant to 26 U.S.C. 7443A(b)(4) are employees rather than "Officers of the United States."[24]

---

persons chiefly charged with the enforcement of the peace of the United States, as that is embraced in the enforcement of federal law"); *United States* v. *Germaine*, 99 U.S. 508, 511 (1878) ("inferior commissioners and bureau officers" are "mere aids and subordinates"); *United States* v. *Mitchell*, 89 F.2d 805, 808 (D.C. Cir. 1937) (attorneys employed by independent administrative agency are not "Officers" for purposes of Appointments Clause).

[23] Even the ability of special trial judges to regulate proceedings before them is made "[s]ubject to the specifications and limitations in the order designating" the special trial judge, Tax Ct. R. 181, so that regulation of every proceeding remains subject at all times to the complete control of the chief judge of the Tax Court.

[24] On signing the Omnibus Budget Reconciliation Act of 1989, the President addressed a provision authorizing appointment of special masters by the United States Claims Court, and noted that

> an "arbitrary and capricious" standard for review of special master decisions by Claims Court judges could raise constitutional questions by vesting significant authority pursuant to the laws of the United States in persons whose appointment and removal are inconsistent with the requirements of Article II of the Constitution, and by circumscribing the ability of Article

Petitioners' analogy of special trial judges to federal magistrates, Pet. Br. 28, ignores the special trial judges' lack of independent decision-making authority in cases to

I and Article III judges to review the decisions of these persons. Accordingly, to place this issue beyond doubt, the Attorney General and the Secretary of HHS will work together to submit legislation that would ensure *de novo* review of decisions rendered by the special masters.

Statement of the President on Signing the Omnibus Budget Reconciliation Act of 1989, 25 Weekly Comp. Pres. Doc. 1970-1971 (Dec. 19, 1989). Unlike Claims Court special masters, the reports of special trial judges assigned under 26 U.S.C. 7443A(b)(4) are already reviewed *de novo* by the Tax Court judge responsible for deciding the case. See pp. 17-19 & nn.9-10, *supra*. Moreover, the constitutional status of the Tax Court and the Claims Court may not be the same, see, *e.g.*, 28 U.S.C. 176 (Claims Court judges removable by the United States Court of Appeals for the Federal Circuit), and accordingly they may differ in their capacity to appoint inferior Officers.

Although special trial judges may be assigned to render the decision of the court in declaratory judgment proceedings and small tax cases within 26 U.S.C. 7443A(b)(1)-(3), see 26 U.S.C. 7443A(c), petitioners have standing only to assert their own rights, not those of taxpayers whose cases are assigned to special judges under other provisions. See *Powers* v. *Ohio*, No. 89-5011 (Apr. 1, 1991), slip op. 10 ("In the ordinary course, a litigant must assert his or her own legal rights and interests, and cannot rest a claim to relief premised on the legal rights or interests of third parties."). If the special trial judge assigned to *their* cases performed duties that may performed by an employee, petitioners suffered no injury from any defect in appointment. See *Allen* v. *Wright*, 468 U.S. 737, 751 (1984) (Article III standing requires that "[t]he injury must be 'fairly' traceable to the challenged action, and relief from the injury must be 'likely' to follow from a favorable decision."); see also *Buckley* v. *Valeo*, 424 U.S. at 137-139 (members of Federal Election Commission not appointed consistent with the Appointments Clause could continue to perform statutory duties not requiring an Officer). The Tax Court's conclusion in *First Western Government Securities, Inc.* v. *Commissioner*, 94 T.C. 549 (1990), appeal pending *sub nom. Samuels, Kramer & Co.* v. *Commissioner*, Nos. 90-4060 & 90-4064 (2d Cir.) (argued Oct. 24, 1990), that special trial judges are inferior Officers, rested on their ability to decide small cases under 26 U.S.C. 7443A(c)—an authority that the special trial judge assigned to petitioners' cases did not have.

which they are assigned pursuant to 26 U.S.C. 7443A(b)(4)—the only authority at issue in this case. Federal magistrates possess "all powers and duties conferred or imposed upon United States commissioners by law or by the Rules of Criminal Procedure for the United States District Courts." 28 U.S.C. 636(a)(1).[25] United States commissioners, in turn, possessed extensive power, "including the power to arrest and imprison for trial * * * and to institute [certain] prosecutions." *Morrison* v. *Olson*, 487 U.S. 654, 673 (1988); *Go-Bart Importing Co.* v. *United States*, 282 U.S. 344, 353 n.2 (1931). A special trial judge assigned under 26 U.S.C. 7443A(b)(4), in contrast, exercises no such similar authority—indeed, no *independent* authority whatever. For that reason, this Court's cases holding that United States commissioners and federal magistrates are inferior Officers, *Go-Bart Importing Co.* v. *United States*, 282 U.S. at 352; *Rice* v. *Ames*, 180 U.S. 371, 378 (1901), do not establish that special trial judges assigned under 26 U.S.C. 7443A(b)(4) are also exercising powers that may be performed only by inferior Officers.

It is true that magistrates, like special trial judges, may be assigned to conduct hearings and to submit proposed findings of fact and recommendations for disposition. 28 U.S.C. 636(b)(1)(B). The findings and proposed opinion of the magistrate, however, are reviewed by the District Court only if the parties object. 28 U.S.C. 636(b)(1)(B); see *United States* v. *Raddatz*, 447 U.S. 667, 673 (1980). By comparison, the Tax Court judge must decide every case assigned to a special trial

[25] With the consent of the parties, magistrates are also "authorized to preside at and enter final judgment in civil trials, including those tried before a jury * * * [and] to conduct jury as well as bench trials on any misdemeanor charge," 28 U.S.C. 636(a)(4) and (c)(1), as this Court pointed out in *Gomez*, 490 U.S. at 870. In such trials, appeal may then be taken directly to the court of appeals (unless the parties also consent to appeal to a judge of the District Court). 28 U.S.C. 636(c)(1) and (3).

judge under 26 U.S.C. 7443A(b)(4); no objection or exception to the special trial judge's report is necessary or even possible, because submission of the special trial judge's report is a matter internal to the Tax Court. See Pet. App. A8 n.8; pp. 19-20 n.10, *supra*.

Moreover, the conduct of evidentiary hearings is not confined to Officers of the United States. This Court has frequently gathered evidence through assistants who were not appointed in conformity with the Appointments Clause. As early as *Pennsylvania* v. *Wheeling & Belmont Bridge Co.*, 50 U.S. (9 How.) 647, 657 (1850), the Court, on its own motion and without statutory authority, appointed a commissioner to take evidence and to provide a report to the Court. That practice continues to this day. See, *e.g.*, *United States* v. *Louisiana*, 394 U.S. 11, 78 (1969); *South Carolina* v. *Regan*, 465 U.S. 367, 382 (1984). See generally R. Stern, E. Gressman & S. Shapiro, *Supreme Court Practice* § 10.12, at 494-497 (6th ed. 1986). Similarly, in *Ex parte Peterson*, 253 U.S. 300, 312-314 (1920), the Court held that the United States District Court for the Southern District of New York had "inherent power" to appoint third persons to take testimony and report to the court. Although the Supreme Court and the lower Article III courts are all "Courts of Law" in which Congress *could* vest authority to appoint "inferior Officers," the Appointments Clause is explicit that appointment power is not inherent, but exists only as "Congress may by Law" confer. See *Young* v. *United States ex rel. Vuitton et Fils S.A.*, 481 U.S. 787, 816 n.1 (1987) (Scalia, J., concurring in judgment). This Court's longstanding recognition of Article III courts' power to appoint special masters necessarily implies that such special masters are not Officers of the United States subject to the Appointments Clause. By analogy, the Tax Court chief judge's appointment of special trial judges to hear and report on cases under 26 U.S.C. 7443A(b)(4) does not implicate the Appointments Clause.

B. If Special Trial Judges Are Officers, They Are Inferior Officers Whom The Tax Court Chief Judge, As "Head[] of Department[]," May Appoint

If special trial judges are Officers of the United States, they are at most inferior Officers.[26] The Exceptions Clause to the Appointments Clause states that "Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments." Art. II, § 2, Cl. 2. Since Congress has provided by law that the Tax Court "chief judge may, from time to time, appoint special trial judges," 26 U.S.C. 7443A(a), the appointment of the special trial judge who heard petitioners' cases is valid if the chief judge is a "Court[] of Law" or a "Head[] of Department[]."

The validity of the special trial judge's appointment therefore turns on the constitutional status of the Tax Court. As an initial matter, the Tax Court must be located within one of the three Branches of the federal government. The tripartite structure of the Constitution, and this Court's faithful adherence to that organization, admit of no other alternative. *Bowsher* v. *Synar*, 478 U.S. at 721-722; *INS* v. *Chadha*, 462 U.S. at 951; *Buckley* v. *Valeo*, 424 U.S. at 120-124.

1. It is clear that the Tax Court cannot be in the Legislative Branch. Although Congress theoretically could perform some of the Tax Court's functions by enacting private bills in response to the petitions of individual taxpayers, it could do so only by passing laws in conformity with the Bicameralism and Presentment Clauses. See *INS* v. *Chadha*, 462 U.S. at 951. That

[26] Petitioners' suggestion, Pet. Br. 28 n.26, that special trial judges are principal Officers is fanciful. In *Morrison* v. *Olson*, 487 U.S. at 671, this Court held that an independent prosecutor was "clearly" only an inferior Officer, despite her "full power and independent authority to exercise all investigative and prosecutorial functions and powers of the Department of Justice." Tax Court special trial judges plainly occupy no higher status.

work could not be performed by the Tax Court because legislative power is not delegable: Senators and Representatives could not delegate the power to enact private bills any more than they could "send delegates to consider and vote on bills in their place." *Mistretta* v. *United States*, 488 U.S. 361, 425 (1989) (Scalia, J., dissenting). The notion that the Tax Court may be "an independent judicial body in the legislative branch," Pet. Br. 36 (quoting Office of the Federal Register, Nat'l Archives and Records Admin., *The United States Government Manual* 76 (1989/1990)), must be rejected at the outset as wholly contrary to our system of separated powers.

In fact, the Tax Court does not pass private bills or exercise any other legislative power. Instead, it decides tax controversies between the Commissioner and taxpayers. If the Tax Court were somehow understood to be in the Legislative Branch, the appointment of special trial judges exercising governmental power by the chief judge would plainly violate the Appointments Clause. The very purpose of that Clause is to guard against any intrusion by Congress into the appointments process, beyond the advice and consent role specified in the Constitution.[27] By its terms, the Clause authorizes no legis-

[27] See *Bowsher* v. *Synar*, 478 U.S. at 712-727; *Buckley* v. *Valeo*, 424 U.S. at 129; *Springer* v. *Philippine Islands*, 277 U.S. 189, 202 (1928); The Federalist No. 77, at 518-519 (A. Hamilton) (J. Cooke ed. 1961) ("Every mere council of appointment, however constituted, will be a conclave, in which cabal and intrigue will have their full scope. * * * The example of most of the states in their local constitutions, encourages us to reprobate the idea."); G. Wood, *Creation of the American Republic* 407, 435-436, 452, 551-552 (1969) (granting of appointment powers to state legislatures had been a "principal source of division and faction" in state governments, destroying "all responsibility," creating "a perpetual source of faction and corruption," and, according to Madison, "depart[ing] too far from the Theory which requires a separation of the great Departments of Government").

The Framers were especially anxious to prevent the Legislative Branch from arrogating the power to decide cases. See The Fed-

lative entity to make appointments. If the Tax Court is such an entity, it can have no power to appoint Officers of the United States.

The fact that Congress amended 26 U.S.C. 7441 in 1969 to provide that the Tax Court was established "under article I of the Constitution," Section 951 of the Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 730, does not lead to a contrary conclusion. Most of what Congress does is done "under article I of the Constitution." The terms "Article I courts" or "legislative courts" refer not to the status of those entities in the tripartite structure, but rather to the fact that they are not established under Article III.

2. Nor can the Tax Court be located within the Article III Judicial Branch. Although Congress established the Tax Court as "a court of record," Section 951 of the Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 730, more than that appellation and the function of applying law to fact in particular cases is needed for Article III status. Because tax disputes are "matters, involving public rights, * * * which congress may or may not bring within the cognizance of the courts of the United States, as it may deem proper," *Murray's Lessee* v. *Hoboken Land and Improvement Co.*, 59 U.S. (18 How.) at 284, and because Congress eschewed life tenure and salary protection for Tax Court judges, the Tax Court cannot be considered part of the Judicial Branch under the Constitution. See U.S. Const. Art. III, § 1; *Glidden*, 370 U.S. at 552 (plurality opinion).

eralist No. 47, at 326 (J. Madison) (J. Cooke ed. 1961) ("Were the power of judging joined with the legislative, the life and liberty of the subject would be exposed to arbitrary controul, for *the judge* would then be *the legislator*." (quoting J. Montesquieu, *The Spirit of Laws* (1748))); 1 W. Blackstone, *Commentaries* *259-260 ("Were [judicial power] joined with the legislative, the life, liberty, and property, of the subject would be in the hands of arbitrary judges, whose decisions would be then regulated only by their own opinions, and not by any fundamental principles of law; which, though legislators may depart from, yet judges are bound to observe.").

Because the Tax Court is not part of the Judicial Branch, it is not a "Court[] of Law" within the meaning of the Appointments Clause. The Appointments Clause uses the term "*the* Courts of Law" to refer to those courts created and existing under Article III as part of the Judicial Branch. Although so-called Article I courts created by Congress are "courts" in the generic sense of that term, see *Black's Law Dictionary* 358 (6th ed. 1991), the *only* courts expressly provided for by the Constitution are the courts established under Article III. It is most natural to conclude that when the Constitution refers to "the Courts of Law" it is referring to the Courts of Law specified in that document.[28]

---

[28] Amicus curiae Erwin N. Griswold argues that the Tax Court "naturally falls within the phrase 'Courts of Law' as the Framers used those words in the Appointments Clause." Amicus Br. 9. His only support for the repeated assertion that the *Framers* thought it "natural," *id.* at 7, 9, 12, 18, to lodge the power to appoint inferior Officers in bodies susceptible to congressional influence, however, is the history of territorial courts appointing their own clerks and commissioners. See *id.* at 12-15. Although the Framers surely understood that the territorial courts functioned as "courts" in the generic sense of that term, it does not follow that territorial clerks and commissioners were "inferior Officers" subject to the Appointments Clause, cf. *Metropolitan R.R.* v. *District of Columbia*, 132 U.S. 1, 7-9 (1889); *Hobson* v. *Hansen*, 265 F. Supp. 902, 919-920 (D.D.C. 1967) (three-judge court) (Wright, J., dissenting), or that territorial courts were "Courts of Law" rather than "Departments" within the Executive Branch.

The only historical evidence on this latter point is the Northwest Ordinance of July 13, 1787. As amended by the First Congress, that law provided that "the President shall nominate, and by and with the advice and consent of the Senate, shall appoint all officers which by the said ordinance were to have been appointed by the United States in Congress assembled." Act of Aug. 7, 1789, ch. 8, § 1, 1 Stat. 53. Among those officers were the three judges of the court for the Northwest Territory. 1 Stat. 51 n.(a). Significantly, the First Congress made provisions for compensating those judges in the Act of Sept. 11, 1789, ch. 13, § 1, 1 Stat. 67-68 (Executive Officers in compensation statute included "the three judges of the western territory"), entitled "An Act for Establishing the Salaries of *the Executive Officers of Government*" (emphasis added), and *not* in the parallel provisions of

Limitation of "the Courts of Law" to Article III courts is more than just consistent with the Constitution's tripartite structure. Structure has purpose. The purpose of the Appointments Clause is to prevent Congress from acquiring executive or judicial power through control over the appointment of Officers of the United States. Permitting appointments by Article III "Courts of Law" is faithful to that purpose: because members of the Judiciary enjoy life tenure and protection against salary reduction, their independence from the Legislative Branch in exercising any appointment authority is guaranteed. Likewise, the President and heads of Executive Departments may act independently of the Congress in the exercise of appointment authority by virtue of the checks and balances accorded the Executive Branch in the constitutional scheme. By contrast, a governmental body neither within the Executive Branch nor protected by Article III would be subservient to Congress. Granting such bodies appointment authority for "inferior Officers" would effec-

---

the Act of Sept. 23, 1789, ch. 18, § 1, 1 Stat. 72, providing, *inter alia*, for the compensation of "the judges of the Supreme and other Courts." Cf. Judiciary Act of Sept. 24, 1789, ch. 20, 1 Stat. 73-93 (making no reference to territorial courts). It is well established that an Act "passed by the first Congress assembled under the constitution, many of whose members had taken part in framing that instrument, * * * is contemporaneous and weighty evidence of its true meaning." *Marsh* v. *Chambers*, 463 U.S. 783, 790 (1983) (quoting *Wisconsin* v. *Pelican Ins. Co.*, 127 U.S. 265, 297 (1888)).

Amicus responds to these Acts of the First Congress by downplaying the importance of their titles. But Congress, unlike the English Parliament, "considers and *passes* the entire act including the title, giving authenticity to every component." 2A Sutherland, *Statutes and Statutory Construction* § 47.03, at 121 (N. Singer rev. of C. Sands 4th ed. 1984); see, *e.g.*, *Mead Corp.* v. *Tilley*, 490 U.S. 714, 722-723 (1989) (resolving ambiguity "by the title" of the legislation); *FTC* v. *Mandel Bros.*, 359 U.S. 385, 388-389 (1959) ("The Title of the Act * * *, though not limiting the plain meaning of the text, is nonetheless a useful aid in resolving an ambiguity."); *Maguire* v. *Commissioner*, 313 U.S. 1, 9 (1941) ("While the title of an act will not limit the plain meaning of the text, it may be of aid in resolving an ambiguity." (citations omitted)).

tively place the power to influence and control such appointments in the Congress itself, thereby violating the fundamental separation of powers concerns underlying the Appointments Clause.[29]

3. If the Tax Court cannot be in the Legislative Branch, and if it cannot be in the Judicial Branch, it must be in the Executive Branch.

a. Given the history of the Tax Court, this conclusion should come as no surprise. In 1924, Congress established the Tax Court's predecessor, the Board of Tax Appeals, as "an independent agency in the Executive Branch of the Government." Section 900 of the Revenue Act of 1924, ch. 234, 43 Stat. 336-338.[30] Congress expanded the Board's adjudicatory role,[31] and in 1942 provided that the

[29] Nor is the Tax Court an adjunct of an Article III court. Cf. *Mistretta* v. *United States*, 488 U.S. at 368, 385 (Sentencing Commission is established "as an independent commission in the judicial branch of the United States." 28 U.S.C. 991(a)); 28 U.S.C. 151 (bankruptcy courts constituted as units of the United States district courts). Tax Court judges are not appointed by any court, but by the President, 26 U.S.C. 7443(b); they are not supervised by any court as regards their internal administration, 26 U.S.C. 7453; and they are not removable by any court, 26 U.S.C. 7443(f). The legislative history of the 1969 Tax Court reform underscores that "[t]he committee amendments do not place the Tax Court under the supervision of the Judicial Conference or the Direction of the Administrative Office of the Article III courts or give them any power or control over the Tax Court." S. Rep. 552, 91st Cong., 1st Sess. 304 n.3 (1969); see S. Conf. Rep. No. 782, 91st Cong., 1st Sess. 341 (1969) (House bill had no provisions concerning Tax Court; conference substitute "follows the Senate amendment").

[30] As originally established, its decisions were not directly reviewable by the courts of appeals and were not finally determinative of the liability in question. Rather, the taxpayer or the government could obtain review by bringing, respectively, a separate suit for a refund or a collection suit with respect to the taxes in issue. See *Old Colony Trust Co.* v. *Commissioner*, 279 U.S. 716, 721-722 (1929). Such review was not, strictly speaking, *de novo*, since the statute provided that the findings of the Board would be *prima facie* evidence of the facts.

[31] The Revenue Act of 1926, ch. 27, 44 Stat. 9, provided that the Board's decisions would be directly reviewable by the courts of

Board was thereafter to be "known as The Tax Court of the United States," Section 509 of the Revenue Act of 1942, ch. 619, 56 Stat. 957. Notwithstanding those changes, Congress repeatedly continued the Board of Tax Appeals (and later the Tax Court) as "an independent agency in the Executive Branch of the Government." Section 900 of the 1926 Act, ch. 27, 43 Stat. 104; Section 1100 of the 1939 Code, 26 U.S.C. (1952); Section 7441 of the 1954 Code. Thus, for almost a half century, the Board of Tax Appeals and the Tax Court were located explicitly within the Executive Branch.

To be sure, Congress in 1969 removed the language explicitly stating that the Tax Court was an agency in the Executive Branch and substituted language that it was a "court of record" established "under Article I." 26 U.S.C. 7441. But in doing so, Congress did not—and by that action could not—remove the Tax Court from the Executive Branch. Section 7441 itself does not purport to transfer the Tax Court to another branch of government. Contrast 28 U.S.C. 991(a) (establishing Sentencing Commission "in the judicial branch"). It simply describes the status of the Tax Court as a "court" (it applies law to fact) "of record" (it hears disputes on a record) "established under Article I" (most congressional action is pursuant to Article I). The reference in Section 7441 to Article I of the Constitution—far from differentiating the post-1969 status of the Tax Court from its pre-1969 status—actually repudiates the inference that the Tax Court was transferred to the Judicial Branch (Article III). Nor do any of the other reforms affecting the Tax Court suggest such a drastic change. To the contrary, with the exception of giving the Tax Court contempt power, 26 U.S.C. 7456(c), Congress did nothing to change the nature of the Tax Court's role in re-

appeals and, except as modified or set aside on such review, would be finally determinative of the tax liabilities in issue. This procedure remains to this day. *Old Colony Trust Co.*, 279 U.S. at 722. This Court held those procedures constitutional in *Old Colony Trust Co.* and *Phillips* v. *Commissioner*, 283 U.S. 589 (1931).

viewing the Commissioner's determinations of tax deficiencies. See *Burns, Stix Friedman & Co.* v. *Commissioner*, 57 T.C. 392, 401-402 (1971) (Raum, J., concurring).

Indeed, Congress implicitly intended no substantive change in the Tax Court at all, because it continued the incumbent Tax Court judges in office, specifically providing that "[t]he United States Tax Court established under the amendment made by section 951 is a *continuation* of the Tax Court of the United States *as it existed prior to the date of enactment of this Act*, [and] the judges of the Tax Court of the United States immediately prior to the date of enactment of this Act shall become the judges of the United States Tax Court upon the enactment of this Act." Act of Dec. 30, 1969, Pub. L. No. 91-172, Tit. IX, § 961, 83 Stat. 735-736 (emphases added). Congress could not have continued the sitting judges in office, consistent with the Appointments Clause, if it had made such a dramatic change as reconstituting the Court outside the Executive Branch. See *Olympic Federal Savings & Loan Ass'n* v. *Director, Office of Thrift Supervision*, 732 F. Supp. 1183, 1191-1193 (D.D.C.), appeal dismissed as moot, 903 F.2d 837 (D.C. Cir. 1990). Congress may devolve additional germane duties on existing officers, see *Shoemaker* v. *United States*, 147 U.S. 282, 300-301 (1893), but purporting to establish existing officers in a different branch of government would plainly exceed constitutional limits.[32]

[32] Petitioners suggest that holding the Tax Court to be an Executive Department after 1969 would "override Congress' considered judgment." Pet. Br. 30. Petitioners' only support for this statement, however, is not an Act of Congress but passages in a report prepared by the staff of the Senate Finance Committee. S. Rep. No. 552, *supra*, at 302-304 & n.3. The Finance Committee was apparently misled by the "legislative court" appellation into thinking that Article I courts are part of the Legislative Branch. This Court's decision in *Chadha* makes clear, if it was not clear before, see pp. 33-35, *supra*, that the Tax Court cannot be within the Legislative Branch. The important point is that Congress did not by statute purport to remove the court from the Executive Branch. Since any such effort would violate the Constitution, such an intent should not be attributed to Congress on the basis of dubious legislative history. Cf. *West Virginia University Hospitals, Inc.* v. *Casey*, No. 89-994 (Mar. 19, 1991), slip op. 14-15.

We readily acknowledge that the Tax Court's fit within the Executive Branch may not be a perfect one. Congress did not seem overly punctilious about precisely where in the tripartite scheme the Tax Court belonged when it amended the statute in 1969,[33] and certain features of the Tax Court's organization—in particular the purported protection of the Tax Court judges from removal, 26 U.S.C. 7443(f)—raise serious constitutional concerns in any executive entity. See *Myers* v. *United States*, 272 U.S. 52, 162-164, 177 (1926). How such provisions should be interpreted, however, and whether they would survive constitutional scrutiny, are not questions before the Court in this case. The question that the Court must confront—if it disagrees with us on the employee status of special trial judges and the waiver point—is the more basic one of which of the three branches is home to the Tax Court. How hospitable a home that branch may turn out to be is a question for the future. For the reasons we have set forth, we think it is basic that (1) the Tax Court cannot be in some headless fourth branch, (2) the Tax Court cannot be part of the Legislative Branch, and (3) the Tax Court is not part of the Judicial Branch. It therefore remains, as it was expressly for nearly a half century, part of the Executive Branch.

Petitioners tellingly fail to explain where in the tripartite system they would place the Tax Court. They have not suggested that it is itself unconstitutional, so they must fix it in one of the three branches. They agree

[33] The legislative history of the 1969 amendments suggests that Congress contradictorily intended both to distance the Tax Court from the Executive Branch *and* to keep it outside the Judicial Branch. See S. Rep. No. 552, *supra*, at 302-304 & n.3.

that it is not part of the Article III Judicial Branch, Pet. Br. 33-34, and cannot quite bring themselves to assert that it is part of the Legislative Branch, *id.* at 36 ("the Tax Court *is considered by many* to be 'a legislative body performing judicial functions,' * * * or 'an independent judicial body in the legislative branch'" (emphasis added)). What they do assert repeatedly is that the Tax Court is "an Article I court," *id.* at 29, without elaborating on the significance of that label. Indeed, it is central to their submission that Congress took action in 1969 "to transform the Tax Court from an executive agency into an Article I legislative court," *ibid.*, but they do not explain how—for separation of powers purposes—an "Article I legislative court" is any different from an executive agency.[34]

b. The Appointments Clause does not say simply that Executive Branch entities may appoint inferior Officers; it specifies that "Heads of Departments" may. The term "Head[] of Department[]" means the chief of any component of the Executive Branch that is not subordinate to (or contained within) another component. Cf. Classification Act of 1923, ch. 265, § 2, 42 Stat. 1488 ("'the head of the department' means the officer or group of officers in the department who are not subordinate or responsible to any other officer of the department"). At the time the Constitution was drafted, "department"

[34] See Amar, Marbury, *Section 13, and the Original Jurisdiction of the Supreme Court*, 56 U. Chi. L. Rev. 443, 451 (1989) ("strictly speaking, 'legislative courts' are neither legislative nor courts; rather, they are executive agencies"). Amicus Erwin N. Griswold similarly is content to establish the Tax Court as an Article I court, without explaining what the consequences of such a designation are for the Tax Court's placement in the tripartite system. However many "attributes * * * indicative of a court" the Tax Court may have, Amicus Br. 2, it lacks the key constitutional indicia of an Article III court. Recognizing this fact does not "undervalue" the Tax Court, Amicus Br. 22, because the branches of government are equal and coordinate, rather than arranged in some hierarchical fashion.

meant "Separate allotment; province or business assigned to a particular person." 1 S. Johnson, *A Dictionary of the English Language* (1755). The chief judge is the "Head[]" of the Tax Court, and the Tax Court is a "Department[]" because it is a component of the Executive Branch not contained within any other component.

Petitioners contend that only Officers of cabinet rank are "Heads of Departments." Pet. Br. 30-32 & n.28. The three authorities on which they rely, however, all address the question whether a "Department[]" includes a component of the Executive Branch that is subordinate to or contained within another component of the Executive Branch. Those authorities do not support the much broader proposition that only cabinet members are "Heads of Departments."

Petitioners' first authority is a colloquy between Gouverneur Morris and James Madison on the last working day of the Constitutional Convention. Pet. Br. 32-33. Morris moved to amend the Appointments Clause to provide for the appointment of inferior Officers by the President alone, the Heads of Departments, and the Courts of Law—*i.e.*, what became the Exceptions Clause. Madison objected that the amendment "does not go far enough if it be necessary at all—Superior Officers below Heads of Departments ought in some cases to have the appointment of the lesser offices." 2 M. Farrand, *The Records of the Federal Convention of 1787*, at 627 (1966). The amendment carried over Madison's objection on a second vote. *Ibid.* Although the colloquy suggests that Congress cannot vest in an Officer in charge of a component contained within a department the authority to appoint inferior Officers, it does not support petitioners' contention that the head of a free-standing component of the Executive Branch may not be given the power to appoint inferior Officers.

Petitioners' second authority, Pet. Br. 31—this Court's decisions in *United States* v. *Germaine*, 99 U.S. at 510-511, and *Burnap* v. *United States*, 252 U.S. 512, 515

(1920)—likewise hold only that a component of a department is not itself a department whose head is capable of exercising appointment power. Although those cases portrayed departments as "a great division of the executive branch of the Government, like the State, treasury, and War, who is a member of the Cabinet," *Burnap*, 252 U.S. at 515 (relying on *Germaine*, 99 U.S. at 510), the Court's decisions addressed only the situation in which Congress was asserted to have vested authority to appoint an inferior Officer in the chief of a bureau contained within a cabinet department. The Court had no occasion to consider whether entities standing alone are themselves "Departments." See *Germaine*, 99 U.S. at 511 ("The association of the words 'heads of departments' with the President and the courts of law strongly implies that something different is meant from inferior commissioners and bureau officers, who are themselves the mere aids and subordinates *of the heads of the departments*." (emphasis added)); cf. *Burnap*, 252 U.S. at 515 ("It ['[t]he term head of a Department'] does not include heads of bureaus or lesser divisions." (citing *Germaine*)). This Court's characterizations of the Executive Branch "Departments" as being small in number and led by members of the President's cabinet reflected the context in which those cases arose (involving lesser bureaus within a Department) and were simply descriptive of the composition of the Executive Branch of government at the time.[35]

[35] The cabinet level departments described in *Germaine* and *Burnap* as "Departments" of the Executive Branch were the only departments created by the first Congress. Act of July 27, 1789, ch. 4, § 1, 1 Stat. 28 (Foreign Affairs); Act of Aug. 7, 1789, ch. 7, 1 Stat. 49 (War); Act of Sept. 2, 1789, ch. 12, § 1, 1 Stat. 65 (Treasury); Act of Sept. 15, 1789, ch. 14, § 1, 1 Stat. 68 (renaming Foreign Affairs Department as Department of State).

The first so-called "independent" agency—*i.e.*, independent of other entities in the Executive Branch, emphatically *not* independent of the Executive—was not established until 1887. See Interstate Commerce Act of 1887, ch. 104, § 2, 24 Stat. 379; R. Pierce, S. Shapiro & P. Verkuil, *Administrative Law and Process* 99 (1985). It was not until the 1930s, during President Roosevelt's first term, that such agencies became a significant element in the structure of the Executive Branch. See *id.* at 32-33, 97-101.

Petitioners' third authority consists of definitions used by Congress in unrelated legislation and in committee reports on the Twenty-fifth Amendment. Pet. Br. 30-32. It is true that 5 U.S.C. 101 defines "Executive departments" by means of a list that includes only cabinet departments. But that definition, and the succeeding definitions of "Military departments," "Government corporation," "Independent establishment," and "Executive agency," 5 U.S.C. 102-105, are set forth not for Appointments Clause purposes but for purposes of certain other statutes. See, *e.g.*, 5 U.S.C. 301 (conferring authority to promulgate regulations only on Executive and Military departments); 5 U.S.C. 905(a) (forbidding certain reorganizations involving Executive departments). The fact that the Tax Court may not be covered by these other statutes does not prevent it from being an entity within the Executive Branch for Appointments Clause purposes.

The committee reports on the Twenty-fifth Amendment recognize that "Heads of Departments" includes more than the members of the President's Cabinet. The House of Representatives' original proposal for that Amendment provided for the transfer of the President's power to the Vice President upon the written declaration by the Vice President and a majority of the "heads of the executive departments" that the President was unable to discharge the power and duties of his office. The House of Representatives subsequently amended that language to require written declaration of the President's inability to discharge his duties from a majority of the "Principal officers of the executive departments," rather than from a majority of the "heads of the executive departments," in order *"to make it clearer that only officials of Cabinet rank should participate in the*

decision as to whether presidential inability exists." H.R. Rep. No. 203, 89th Cong., 1st Sess. 3, 15-16 (1965) (emphasis added). There would have been no need to abandon the language under which the written declarations would be provided by the "heads of the executive departments" if that language embraced only members of the President's cabinet.[36]

Petitioners' definition of executive "Department[]" to exclude free-standing components of the Executive Branch is more than just poor semantics. It deprives all non-Article III courts and nearly 50 free-standing agencies of the Executive Branch, see 55 Fed. Reg. 44,196 (1990), of the ability to appoint inferior Officers. Petitioners concede that acceptance of their position will remove appointment authority from all non-Article III courts. Pet. Br. 40.[37] They insist, however, that "all other adjudicatory officers and agents in the federal government are different from Tax Court special trial judges in significant ways." Pet. Br. 38.

But petitioners' conclusion—based on their examination of administrative law judges and staff attorneys of the Securities and Exchange Commission—depends on the remarkable assertion that *all* individuals in agencies (except their heads) are "employees."[38] Pet. Br. 39. Without painting a bulls-eye on inferior Officers whose appointments would be rendered invalid under petitioners' theory, we think it obvious that between the "employees" and "heads" of agencies are a significant number of inferior Officers. Cf. 3 J. Story, *Commentaries on the Constitution of the United States* § 1538 (1833) ("'inferior officers,' * * * probably includes ninety-nine out of a hundred of the lucrative offices in the government"). Here petitioners meet themselves coming and going. For if inferior Officers include legal assistants who hear and report on tax cases—as petitioners argue in asserting that special trial judges are not mere employees, Pet. Br. 27-28—they surely account for a large number of positions in agencies as well. And their appointments, if made by the heads of those allegedly non-"departmental" components of the Executive Branch, would all be invalid under petitioners' iconoclastic submission.

It is no answer to say, as petitioners do, Pet. Br. 38, that Congress may vest the authority to appoint all inferior Officers in the President alone. That is of course true. But in providing for the appointment of inferior Officers by the Heads of Departments, the Framers anticipated a time when appointment by the President alone of all inferior Officers in the Executive Branch would be inconvenient, if not infeasible. See 2 M. Farrand, *supra*, at 539 ("[Mr. King] did not suppose it was meant that all the minute officers were to be appointed by the

---

[36] Even if petitioners' interpretation were correct, "Department" may have a different meaning in the Twenty-fifth Amendment than it does in the Appointments Clause, just as its carries a different meaning in the Necessary and Proper Clause, Art. I, § 8, Cl. 18, than it does in the Appointments Clause.

[37] In addition to the Tax Court, non-Article III courts include the original Court of Claims (prior to 1953), *Glidden*, 370 U.S. at 531-532 (plurality opinion); see *Williams* v. *United States*, 289 U.S. 553 (1933); the current Claims Court, 28 U.S.C. 171; the Court of Military Appeals, 10 U.S.C. 941; courts in the District of Columbia, see *Northern Pipeline Construction Co.* v. *Marathon Pipe Line Co.*, 458 U.S. 50, 65 (1982) (plurality opinion); various district courts (*e.g.*, the United States District Court for the Virgin Islands, 42 U.S.C. 1611-1617); and, most recently, the Court of Veterans' Appeals, Act of Nov. 18, 1988, Pub. L. No. 100-687, § 301, 102 Stat. 4113 (codified at 38 U.S.C. 4051).

[38] With respect to administrative law judges, that conclusion rests on linguistic sleight-of-hand, Pet. Br. 39 n.37—an irrelevant legislative use of the term "presiding employees" in the Administrative Procedure Act, 5 U.S.C. 554(d), 556(b) and (c), 557(b). See *Buckley* v. *Valeo*, 424 U.S. at 128 n.165 (ignoring Congress's designation of status of Comptroller General as a "legislative officer"). It bears noting that the definition of "Employee" later in Title 5 includes "officers." 5 U.S.C. 2105(a).

* * * original source, but by the higher officers of the departments to which they belong.").[39]

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

KENNETH W. STARR
Solicitor General

SHIRLEY D. PETERSON
Assistant Attorney General

JOHN G. ROBERTS, JR.
Deputy Solicitor General

STEPHEN J. MARZEN
Assistant to the Solicitor General

GARY R. ALLEN
STEVEN W. PARKS
Attorneys

APRIL 1991

[39] See also H. Storing, *The Complete Anti-Federalist* 2.8.173-176 (1981) (Federal Farmer, No. 14, Jan. 17, 1788) ("We may fairly presume, that the judges, and principal officers in the departments, will be able well informed men in their respective branches of business; that they will, from experience, be best informed as to proper persons to fill inferior offices in them; that they will feel themselves responsible for the execution of their several branches of business, and for the conduct of the officers they may appoint therein.—From these, and other considerations, I think we may infer, that impartial and judicious appointments of subordinate officers will, generally, be made by the courts of law, and the heads of departments.").

APPENDIX

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Appointments Clause, Art. II, § 2, Cl. 2, of the United States Constitution, provides in pertinent part as follows:

> He [the President] * * * shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.

Section 7441 of the Internal Revenue Code (26 U.S.C.) provides as follows:

> **Status**
>
> There is hereby established, under article I of the Constitution of the United States, a court of record to be known as the United States Tax Court. The members of the Tax Court shall be the chief judge and the judges of the Tax Court.

Section 7443A of the Internal Revenue Code (26 U.S.C.) provides in pertinent part as follows:

> **Special trial judges**
>
> (a) **Appointment**
>
> The chief judge may, from time to time, appoint special trial judges who shall proceed under such rules and regulations as may be promulgated by the Tax Court.

(b) Proceedings which may be assigned to special trial judges

The chief judge may assign—

(1) any declaratory judgment proceeding,

(2) any proceeding under section 7463,

(3) any proceeding where neither the amount of the deficiency placed in dispute (within the meaning of section 7463) nor the amount of any claimed overpayment exceeds $10,000, and

(4) any other proceeding which the chief judge may designate,

to be heard by the special trial judges of the court.

(c) Authority to make court decision

The court may authorize a special trial judge to make the decision of the court with respect to any proceeding described in paragraph (1), (2), or (3) of subsection (b), subject to such conditions and review as the court may provide.

☆ U. S. GOVERNMENT PRINTING OFFICE; 1991 282061 20457

FOR ARGUMENT

No. 90-762

(9)

Supreme Court, U.S.
FILED
APR 5 1991
OFFICE OF THE CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1990

THOMAS L. FREYTAG, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

SUPPLEMENTAL BRIEF FOR THE RESPONDENT

KENNETH W. STARR
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 514-2217

44 P

BEST AVAILABLE COPY

In the Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-762

THOMAS L. FREYTAG, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

SUPPLEMENTAL BRIEF FOR THE RESPONDENT

Pursuant to Rule 25.5 of the Rules of this Court, the Solicitor General wishes to inform the Court that the Second Circuit rendered a decision on April 2, 1991, in the related cases of *Samuels, Kramer & Co.* v. *Commissioner*, Nos. 90-4060 & 90-4064. The Second Circuit's opinion addresses two of the three questions before the Court in *Freytag*; it is reprinted as an appendix to this brief.

Samuels, Kramer sought the Tax Court's redetermination of deficiencies arising out of the same tax shelter scheme as the one in which petitioners invested; in fact, Samuels, Kramer is one of the principal promoters of that scheme. Samuels, Kramer's cases—unlike petitioners'—were not selected by the Tax Court as test cases and no proceedings have been

held on the merits. By orders dated January 5, 1988, and August 30, 1989, the Tax Court chief judge assigned Samuels, Kramer's cases to a special trial judge under 26 U.S.C. 7443A(b)(4). Unlike petitioners, Samuels, Kramer objected to that assignment in the Tax Court on the ground that it exceeded the authority conferred by Section 7443A(b)(4). Again unlike petitioners, Samuels, Kramer also argued in the Tax Court that the Tax Court chief judge's appointment of the special trial judge violated the Appointments Clause, Art. II, § 2, Cl. 2. In an opinion reviewed by the full court, the Tax Court rejected both contentions: it held that Section 7443A(b)(4) authorized the assignment and that the special trial judge was appointed in accordance with the Appointments Clause because the Tax Court is a "Court[] of Law" which can appoint inferior Officers.

The Second Circuit affirmed the Tax Court's interlocutory ruling. First, the court of appeals held that "the plain language of section 7443A and its legislative history" authorizes "the Chief Judge of the Tax Court to assign any tax case, regardless of complexity or amount in controversy to a special trial judge for adjudication." App., *infra*, 13a; see Gov't Br. 10-20. Second, the court of appeals held that the Tax Court chief judge's appointment of special trial judges does not violate the Appointments Clause. Although the court held that Samuels, Kramer did not waive this challenge, App., *infra*, 15a-18a,[1] and that special trial

[1] The court of appeals "distinguish[ed]" *Samuels, Kramer* from this case because Samuels, Kramer—unlike petitioners—"challenged the assignment of its cases to a special trial judge from the outset." App., *infra*, 15a. The argument in *Samuels, Kramer* was the quite different one that the taxpayer had waived its objection by electing to proceed in the Tax Court, rather than paying the deficiency and seeking a refund in the

judges are inferior Officers, *id.* at 18a-21a; but see Gov't Br. 28-32, it concluded that the Tax Court is a "Department[]" in the Executive Branch and that the chief judge is its "Head[]," App., *infra*, 31a-40a; see Gov't Br. 38-48.[2]

Respectfully submitted.

KENNETH W. STARR
Solicitor General

APRIL 1991

District Court. *Ibid.* The holding in *Samuels, Kramer* thus does not speak to the waiver question before the Court in this case, although the Second Circuit did read this Court's decision in *CFTC* v. *Schor*, 478 U.S. 833 (1986), as supporting the proposition that "[s]tructural protections such as those embodied in the Appointments Clause" cannot be waived, App., *infra*, 17a; but see Gov't Br. 23-28.

[2] The court of appeals rejected the Tax Court's ruling and amicus curiae Erwin N. Griswold's contention that the Tax Court is a "Court[] of Law" within the meaning of the Appointments Clause. App., *infra*, 26a-31a; see Gov't Br. 35-38.

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Nos. 274, 275 August Term, 1990

(Argued October 24, 1990 Decided April 2, 1991)

Docket Nos. 90-4060, 90-4064

SAMUELS, KRAMER & COMPANY,
PETITIONER-APPELLANT

v.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT-APPELLEE

Before: MESKILL and ALTIMARI, *Circuit Judges*, and METZNER,* *District Judge*.

MESKILL, *Circuit Judge*:

Samuels, Kramer, & Company (the Company) challenges the authority of the Chief Judge of the United States Tax Court to appoint "special trial judges" and to assign the adjudication of tax cases involving complex issues and substantial deficiency

---

* Honorable Charles M. Metzner, United States District Judge for the Southern District of New York, sitting by designation.

assessments to these "special judges" pursuant to 26 U.S.C. §§ 7443A(a) and 7443A(b)(4). The Company submits that section 7443A does not authorize the assignment of such cases to "special trial judges," and if authorized, the Chief Judge's appointment of such judges violates the Appointments Clause of the United States Constitution, Article II, Section 2, Clause 2.

BACKGROUND

The Company is a Nevada corporation with its principal place of business in New York City. The Company invested, for itself and for others, in straddles in forward contracts to buy and to sell government securities. Specifically, the Company would agree to buy (a long position) or to sell (a short position) at a pre-set price certain securities on a specific date in the future. As a straddle investor, the Company would hold an equal number of long and short positions in the same underlying security. This investment strategy permitted favorable tax treatment of both gains and losses.

In July 1984, after auditing the Company's tax returns for the years 1979, 1980, and 1981, the Commissioner of the Internal Revenue Service (Commissioner) notified the Company of a tax deficiency in an aggregate amount of approximately $1.4 million. The Commissioner also imposed pursuant to 26 U.S.C. § 6653(b) a civil fraud penalty of $568,291 in connection with the Company's return for the 1979 tax year and assessed interest at the penalty rate of 120 percent of the ordinary underpayment rate pursuant to 26 U.S.C. § 6621(c)(1). In March 1986, after auditing the Company's return for the tax year ending October 31, 1982, the Commissioner notified the Company of a deficiency in the amount of $20,300

and assessed additional penalties. In both instances, the Commissioner asserted that the Company's straddle investments were sham transactions which lacked economic substance and which had not been entered into for profit. Indeed, with respect to the pre-1982 tax years, the IRS took the position that these transactions were "entered into solely or primarily to reduce income taxes by converting short term capital gain and ordinary income to long term capital gain income and defer reporting the same." The Commissioner asserted several other arguments to support the deficiency assessment.

In response to these notifications and assessments, the Company availed itself of its right to contest the deficiencies in the United States Tax Court. The Company filed two petitions with the Tax Court seeking redetermination of the deficiencies. The Chief Judge of the United States Tax Court, Arthur L. Nims, III, acting pursuant to 26 U.S.C. § 7443A and Tax Court Rules of Practice and Procedure 180, 181, and 183, assigned each of the Company's petitions to special trial judge Carleton D. Powell "for trial or other disposition."

The Company and other Tax Court petitioners, who also had their cases assigned to a special trial judge, moved to vacate the assignment of their cases on the grounds that the assignment was not authorized by section 7443A, and, if authorized by section 7443A, violated the Appointments Clause of the Constitution, Article II, Section 2, Clause 2. The Tax Court consolidated the cases for purposes of ruling on the motions to vacate the assignments.

On April 9, 1990, in an opinion reviewed by the full Tax Court pursuant to 26 U.S.C. § 7460(b), the Tax Court denied the motions to vacate the assign-

ments (two judges did not participate). *First Western Gov't Sec., Inc.* v. *Commissioner*, 94 T.C. 549 (1990). The Tax Court concluded (1) that the language, structure, and legislative history of section 7443A clearly demonstrates Congress' intent to assign "any other proceeding" to a special trial judge for hearing and report, and (2) that the Tax Court is a "Court of Law" within the meaning of the Appointments Clause and that special trial judges are "inferior officers" within the meaning of that Clause. Thus, the Tax Court held that the appointment of a special trial judge by the Chief Judge of the Tax Court comported with the Appointments Clause.[1] In an order accompanying its opinion, the Tax Court certified the issues advanced by the Company and the other petitioners for interlocutory appeal pursuant to 26 U.S.C. § 7482(a)(2). The Tax Court also stayed all the proceedings pending resolution of any interlocutory appeal. On April 18, 1990, the Company filed a motion in this Court for leave to appeal and on May 16, 1990, we granted the motion.

DISCUSSION

The United States Tax Court was created by Congress to provide taxpayers with a means of challenging assessments made by the Commissioner without first having to pay the alleged deficiency. Without such a forum, taxpayers would have to pay the asserted deficiency and then initiate a suit in federal district court for a refund. The Tax Court is currently composed of nineteen judges who are appointed by the President with the advice and consent of the

[1] Appearing as *amicus curiae*, Erwin N. Griswold, former Solicitor General, submits that the Tax Court's decision should be affirmed in all respects.

Senate. The judges serve fifteen year terms and are paid at the same rate and in the same installments as federal district court judges. 26 U.S.C. § 7443.

The Company does not challenge the legitimacy of the Tax Court. Rather, the Company questions the constitutional authority of the Chief Judge of the Tax Court to appoint "special trial judges" and his statutory authority to assign large tax cases to these judges for adjudication. We, therefore, must address two basic issues: (1) whether 26 U.S.C. § 7443A permits the assignment of a tax case that involves complex issues and a large deficiency assessment to a "special trial judge" for adjudication, and (2) if permitted, whether the Appointments Clause of the Constitution permits the Congress to vest the Chief Judge with the power to appoint a "special trial judge."

A. *Scope of Review*

The Courts of Appeals have jurisdiction to review the decisions of the Tax Court. 26 U.S.C. § 7482(a)(1). In general, Tax Court decisions are to be reviewed "in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury." 26 U.S.C. § 7482(a). An appeal of an interlocutory order, however, is permissive and is not a matter of right. *Id.* at § 7482(a)(2)(A). Here, we granted the application of the taxpayer to review the Tax Court's interlocutory order addressing the authority of the Chief Judge to appoint special trial judges and to assign complex cases to these judges. The questions before us present pure issues of law. As such, we review the Tax Court's determination *de novo*. *Vukasovich, Inc.* v. *Commissioner*, 790 F.2d 1409, 1413 (9th Cir. 1986).

B. *Authority Under Section 7443A*

In challenging the power of the Chief Judge of the Tax Court to assign cases to a "special trial judge," the Company asserts that the language and structure of section 7443A clearly demonstrate that Congress did not intend complex tax cases involving substantial deficiencies to be assigned to special trial judges. We, therefore, must interpret the language of this provision.

"It is axiomatic that '[t]he starting point in every case involving construction of a statute is the language itself.'" *Landreth Timber Co.* v. *Landreth*, 471 U.S. 681, 685 (1985) (quoting *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, *J.*, concurring)). The plain meaning of the statute's language should control except in the "rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters." *Griffin* v. *Oceanic Contractors, Inc.*, 458 U.S. 564, 571 (1982). In such cases it is the intention of the legislators, rather than the strict language, that controls. *Id.* Finally, "in expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy." *Pilot Life Ins. Co.* v. *Dedeaux*, 481 U.S. 41, 51 (1987) (citations omitted). With these guiding principles in mind, we turn to the statute and its language.

Section 7443A confers on the Chief Judge of the Tax Court the authority to appoint a special trial judge and to assign certain tax cases to such judges for adjudication. Section 7443A provides, in pertinent part:

(a) *Appointment*

The chief judge may, from time to time, appoint special trial judges who shall proceed under such rules and regulations as may be promulgated by the Tax Court.

(b) *Proceedings which may be assigned to special trial judges*

The chief judge may assign—

(1) any declaratory judgment proceeding,

(2) any proceeding under section 7463,

(3) any proceeding where neither the amount of the deficiency placed in dispute (within the meaning of section 7463) nor the amount of any claimed overpayment exceeds $10,000, and

(4) *any other proceeding which the chief judge may designate* (emphasis added),

to be heard by the special judges of the court.

(c) *Authority to make court decision*

The court may authorize a special trial judge to make the decision of the court with respect to any proceeding described in paragraph (1), (2), or (3) of subsection (b), subject to such conditions and review as the court may provide.

26 U.S.C. § 7443A.

The central question we must address is whether the phrase "any other proceeding," which is found in subsection (b)(4), permits the assignment of any tax case to a special trial judge, or if (b)(4) assignments are limited to small and non-complex cases. The Company concedes that the phrase "any other proceeding" when read in isolation could be construed

to permit the assignment of cases similar to those that provided the basis for this appeal. The Company, however, relying on the rule of *ejusdem generis*,[2] argues that given the entire structure of section 7443A the phrase "any other proceeding" should not be read so broadly. It is the Company's view that the phrase "any other proceeding" only encompasses proceedings of a similar nature to those enumerated in section 7443A(b)(1)-(3), *i.e.*, matters that involve a small amount, matters that do not involve complex issues, and matters in which the scope of trial is limited. Any other interpretation, reasons the Company, would render the limitations imposed by subsection 7443A (b)(1)-(3) a nullity. In support of this argument, the Company relies on the Supreme Court's decision in *Gomez* v. *United States*, 490 U.S. 858 (1989).

In *Gomez*, the Supreme Court construed the provisions of the Federal Magistrates Act, 28 U.S.C. § 631 *et seq.* In particular, one section of the Magistrates Act permitted federal magistrates to "be assigned such additional duties as are not inconsistent with the Constitution and laws of the United States." 28 U.S.C. § 636(b)(3)/. This general grant of authority followed a list of specifically enumerated duties which a district judge could delegate to a magistrate. The question before the Court was whether this general provision permitted the assignment to a magistrate of juror *voir dire* in a criminal case. In holding that the Magistrates Act did not permit a district court to assign *voir dire*, the Court stated:

[2] This is a rule of statutory construction that provides that when general words follow the enumeration of particular classes, the general words should be construed as applying only to things of the same general class as those enumerated. Blacks Law Dictionary 517 (6th ed. 1990).

> When a statute creates an office to which it assigns specific duties, those duties outline the attributes of the office. Any additional duties performed pursuant to a general authorization in the statute reasonably should bear some relation to the specified duties.

Gomez, 490 U.S. at 864. The Court concluded that Congress did not intend magistrates to preside over important stages of a felony trial. Jury *voir dire* was found to be one of these important stages. The Court rested its decision on two grounds: (1) the statute expressly specified those functions that magistrates were authorized to conduct, and (2) the legislative history was replete with statements that magistrates were only to handle "subsidiary matters" thereby demonstrating Congress' intent to limit the responsibilities of the magistrates. *Id.* at 872.

The Company's reliance on *Gomez* is misplaced. Here, unlike the situation in *Gomez*, the statute itself draws a distinction between the categories of cases enumerated in subsections (b)(1)-(3) and the category of "any other proceeding" found in subsection (b)(4). The first three categories are (1) declaratory judgment proceedings, (2) small cases involving less than $10,000 conducted under section 7463, and (3) other cases involving less than $10,000. Where a special trial judge is assigned a case pursuant to subsections (b)(1)-(3), the Tax Court *may* authorize the special trial judge to render a final decision. 26 U.S.C. § 7443A(c). Special trial judges, however, *cannot* render the final decision of the Tax Court in cases assigned under the fourth category—"any other proceeding."[3] *See id.*

[3] To implement this statutory provision, the Tax Court, pursuant to the authority conferred by 26 U.S.C. § 7453,

This statutory distinction demonstrates that Congress intended to differentiate (b)(4) cases, in which the ultimate decisional authority remains with the Tax Court, from those cases in which a special trial judge may make the final decision. Congress' decision to vest final decisional authority exclusively in the Tax Court in subsection (b)(4) cases is a clear indication of its intention to permit the assignment of complex cases to special trial judges. We, therefore, decline to adopt the Company's proposed construction because to do so would render superfluous the distinction drawn by the plain language of subsection (c).

The legislative history of section 7443A lends little, if any, support to the Company's argument. Under 26 U.S.C. § 7456 (1982), the predecessor to section 7443A, special trial judges were referred to as "com-

---

promulgated Rule 183 of the Tax Court Rules of Practice and Procedure. Rule 183 further defines the respective functions of the special trial judges and the Tax Court in cases where the amount in dispute exceeds $10,000. After conducting the trial and after the submission of any briefs, the special trial judge must submit a report, including his findings of fact and conclusions of law, to the chief judge, who in turn assigns the case to a Division of the Tax Court. Rule 183(b). Rule 183(c) addresses the duties and authority of the Tax Court Division:

> The Division to which the case is assigned may adopt the Special Trial Judge's report or may modify it or reject it in whole or in part, or may direct the filing of additional briefs or may receive further evidence or may direct oral argument, or may recommit the report with instructions. Due regard shall be given to the circumstance that the Special Trial Judge had the opportunity to evaluate the credibility of witnesses, and the findings of fact recommended by the Special Trial Judge shall be presumed to be correct.

missioners."[4] Tax Reform Act of 1984, P.L. No. 98-369, §§ 463, 464, 1984 U.S. Code Cong. & Admin. News (98 Stat.) 824-25. The commissioners were only authorized to hear minor tax cases and declaratory judgment disputes. *See* 26 U.S.C. § 7456 (1982) (current version at 26 U.S.C. § 7443A). These small cases could not be appealed and they had no precedential value. *Id.* In 1984 Congress made several amendments to section 7456. Specifically, the term "special trial judge" was adopted to replace the term "commissioner," section (d)(3) was changed to raise the maximum amount in dispute provision from $5,000 to $10,000, and subsection (d)(4) providing for the assignment of "any other proceeding" was added. Tax Reform Act of 1984, §§ 463, 464. At the same time, the Chief Judge was given authority to permit special trial judges to render final decisions in cases arising under subsections (d)(1)-(3). *Id.* The statutory provisions addressing the role of special trial judges were ultimately consolidated and recodified in section 7443A. Tax Reform Act of 1986, P.L. No. 99-514, § 1566, 1986 U.S. Code Cong. & Admin. News (99 Stat.) 2754-55 (recodifying section 7456(d)(1)-(4) at section 7443A(b)(1)-(4) & (c)).

The Company submits that Congress, in adopting these amendments, did not intend to grant special trial judges the authority to hear complex cases. The Company places great emphasis on the limited legislative history that accompanied the amendments. In explaining the basis for adopting the present section

---

[4] The provisions that parallel those currently found in section 7443A(b)(1)-(3) were previously codified at section 7456(d)(1)-(3).

7443A(b)(4), the Report of the Committee on Ways and Means stated:

Reasons for Change

> The committee wishes to clarify that additional proceedings may be assigned to Commissioners [Special Trial Judges] so long as a Tax Court judge must enter the decision.

Explanation of Provision

> A technical change is made to allow the Chief Judge of the Tax Court to assign any proceeding to a special trial judge for hearing and to write proposed opinions, subject to review and final decision by a Tax Court judge, regardless of the amount in issue. However, special trial judges will not be authorized to enter decisions in this latter category of cases.

H.R. Rep. No. 432, 98th Cong., 2nd Sess. 1568, *reprinted in* 1984 U.S. Code Cong. & Admin. News 697, 1198. The Company focuses on the phrase "a technical change" and argues that its use indicates that Congress did not intend to expand substantively the authority of special trial judges. We disagree.

When read in its entirety, the legislative history shows that Congress knowingly expanded the authority of special trial judges and appreciated the significance of that action. In particular, Congress not only removed the "maximum amount in dispute" jurisdictional requirement, but also precluded special trial judges from entering the final decision in any cases assigned pursuant to this provision. That responsibility was reserved exclusively for judges of the Tax Court. As the Conference Report emphasized: "The House Bill also provides that other proceedings

may be assigned to be heard by [special trial judges], but no decision with respect to these proceedings may be made by a [special trial judge]." H.R. Conf. Rep. No. 861, 98th Cong., 2nd Sess. 1127, *reprinted in* 1984 U.S. Code Cong. & Admin. News 1445, 1815.

Given the plain language of section 7443A and its legislative history, we conclude that Congress in using the phrase "any other proceeding" intended to authorize the Chief Judge of the Tax Court to assign any tax case, regardless of complexity or amount in controversy to a special trial judge for adjudication. We reach this conclusion ever mindful of the settled rule of construction that requires " '[f]ederal statutes . . . to be so construed as to avoid serious doubt of their constitutionality.' " *Commodity Futures Trading Comm'n* v. *Schor*, 478 U.S. 833, 841 (1986) (quoting *Machinists* v. *Street*, 367 U.S. 740, 749 (1961). We recognize that our construction of section 7443A raises serious questions under the Appointments Clause of Article II of the Constitution. When confronted with such a situation, however, the Supreme Court has counselled:

> [T]his canon of construction does not give a court the prerogative to ignore the legislative will in order to avoid constitutional adjudication; " '—[a]lthough this Court will often strain to construe legislation so as to save it against constitutional attack, it must not and will not carry this to the point of perverting the purpose of a statute . . .' or judicially rewriting it."

Id. (quoting *Aptheker* v. *Secretary of State*, 378 U.S. 500, 515 (1964) (quoting *Scales* v. *United States*, 367 U.S. 203, 211 (1961))). Unable, in this instance, to avoid the plain import of the statute's language

and of Congress' intent, we now direct our attention to the Company's constitutional challenge.

C. *The Appointments Clause*

The Company submits that if section 7443A is found to permit the assignment of complex cases involving large amounts in controversy to a special trial judge, then the statute violates the Appointments Clause of the Constitution, Article II, Section 2, Clause 2. It argues that a special trial judge is an "officer" of the United States who must be appointed in compliance with the Appointments Clause. The Appointments Clause provides in pertinent part:

> [The President] shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.

Thus, the Constitution divides into two classes all the nation's officers that are deemed subject to appointment. *United States* v. *Germaine*, 99 U.S. 508, 509 (1879). "Principal officers are selected by the President with the advice and consent of the Senate. Inferior officers Congress may allow to be appointed by the President alone, by the heads of departments, or by the Judiciary." *Buckley* v. *Valeo*, 424 U.S. 1, 132 (1976) (per curiam). Assuming that a special

trial judge is an "officer," the Company contends that the Chief Judge of the Tax Court does not fall within any of the Constitution's three repositories of the appointment power.

1. *Waiver*

As the outset, we address the Commissioner's argument that the Company has waived its right to challenge the constitutional propriety of section 7443A. The Commissioner contends that the Company waived its right to challenge the constitutionality of section 7443A when it chose to litigate its tax deficiencies in the Tax Court, rather than to pay the tax assessed and then seek a refund in federal district court. We disagree.

Although it is true that the company affirmatively elected to proceed in the Tax Court, this choice of forum in itself cannot be equated with a waiver of constitutional safeguards. The Commissioner cites *Freytag* v. *Commissioner*, 904 F.2d 1011, 1015 n.9 (5th Cir. 1990), *cert. granted*, 59 U.S.L.W. 3501 (U.S. Jan. 22, 1991), to support the proposition that taxpayers who voluntarily submit to having their claims adjudicated in the Tax Court waive certain constitutional protections.[5] In *Freytag*, the taxpayer first raised the Appointments Clause challenge to section 7443A on appeal and no objection was made at the time of the initial assignment of the case. This fact in itself serves to distinguish *Freytag* from the instant case wherein the Company challenged the assignment of its cases to a special trial judge from the outset. However, the Commissioner, relying on

---

[5] We note that the *Freytag* Court addressed the waiver issue in a footnote, but did not examine any of the applicable law. 904 F.2d at 1015 n.9.

Freytag, argues that since Congress need not provide citizens with a forum in which to adjudicate their tax disputes prior to actual payment of an assessment, taxpayers cannot challenge the structure of the forum that Congress chose to create.

It is well settled that Congress has the discretion whether, and to what extent, to waive the government's sovereign immunity. *United States* v. *Testan*, 424 U.S. 392, 399 (1976). Starting from this premise, the Commissioner reasons that when Congress chooses to waive this immunity it can impose whatever conditions it sees fit. We find this analysis to be unduly superficial and fatally flawed. Nothing in the language of section 7443A suggests that Congress intended to limit a citizen's right to challenge the constitutional authority of a statutorily designated decisionmaker. Although Congress can prescribe conditions when it chooses to provide a waiver of sovereign immunity, *Cheatham* v. *United States*, 92 U.S. 85, 88-89 (1976); *Ex Parte Bakelite Corp.*, 279 U.S. 438, 453-54 (1929) (Congress can condition resort to Claims Court on waiver of right to jury trial); *see also* 28 U.S.C. §§ 2674, 2402 (no right to jury trial in federal tort claims actions against the United States), we find no indication that Congress intended to do so in this instance. Here, Congress did not condition resort to the Tax Court on a citizen's waiver of the right to challenge the constitutional authority of the Tax Court's Chief Judge to appoint.[6]

---

[6] As we discuss *infra*, any attempt by Congress to impose such a condition would be inconsistent with the overriding imperatives of the Appointments Clause. *Cf. Speiser* v. *Randall*, 357 U.S. 513, 528-29 (1958) (state cannot impose unconstitutional conditions on the availability of state created rights).

Given that citizens are always free to consent to have their disputes adjudicated by private arbitrators and to waive their personal constitutional rights, the Commissioner also argues that taxpayers can consent to have their disputes resolved by the special trial judges. While the general principles relied on by the Commissioner are well established, *see, e.g.*, *Boykin* v. *Alabama*, 395 U.S. 238, 242-43 (1969) (waiver of right to jury trial by entering guilty plea); *Duncan* v. *Louisiana*, 391 U.S. 145, 158 (1968) (criminal defendant can waive jury trial); *Heckers* v. *Fowler*, 69 U.S. (2 Wall.) 123, 128-29 (1865) (appointment of arbitrator with consent of both parties is permissible); Fed. R. Civ. P. 38(d) (waiver of jury trial in civil cases), we find the situation before use to be of a fundamentally different character. A challenge to the constitutional legitimacy of a governmental decisionmaker is more akin to a challenge based on subject matter jurisdiction. An official's power to act is being directly attacked.

Although it is true that citizens are free to resort to private forums to resolve disputes and to waive personal constitutional rights, where Congress has seen fit to create a public forum, the characteristics of that forum must be consistent with the structural imperatives imposed by the Constitution. Structural protections such as those embodied in the Appointments Clause stand on a different footing from personal constitutional rights. As the Supreme Court has stated, "[t]o the extent that [a] structural principle is implicated in a given case, the parties cannot by consent cure the constitutional difficulty." *Schor*, 478 U.S. at 850-51 (discussing importance of preserving an independent judiciary under Article III). The *Schor* Court's further comments are particularly

applicable here: "[N]otions of consent and waiver cannot be dispositive because the [Constitution's] limitations serve institutional interests that the parties cannot be expected to protect." *Id.* at 851. If an official from the outset lacks the constitutional status that is a prerequisite to holding and to executing the duties of a particular office, we fail to see how a citizen can be deemed to consent to the decisionmaking authority of this official through silence or mere submission to the jurisdiction of the forum of which that official appears to be a member. In order to exercise the powers of an office, the particular official, assuming he or she qualifies as an "officer" of the United States, must be appointed in accordance with the terms of the Appointments Clause. *Buckley*, 424 U.S. at 135, 138-39. Were such institutional interests—as distinguished from personal constitutional rights—so easily waived, the affirmative requirements imposed by the Appointments Clause would effectively be rendered null and void.

2. *Special Trial Judge: Inferior or Superior Officer*

The Company's Appointments Clause challenge is premised on the assumption that a special trial judge is either a principal or inferior officer of the United States. If we conclude that neither characterization is applicable and that a special trial judge is simply an employee, our analysis would be complete. Such "lesser functionaries" need not be selected in compliance with the strict requirements of Article II. *Buckley*, 424 U.S. at 126 n.162.

The Commissioner argues that special trial judges are mere employees because they exercise limited authority. The Company, however, submits that the

duties performed by the special trial judges are quite substantive and require the exercise of broad discretion. Indeed, the Company goes so far as to argue that, as currently utilized, special trial judges function as *de facto* judges of the Tax Court and should be viewed as principal officers subject to Presidential appointment and Senate confirmation. At a minimum, the Company asserts the special trial judges are inferior officers who must be appointed by the President, a "Court of Law," or a "Head of Department." To determine the appropriate manner of classifying the position of special trial judge, we must examine the structure of the Tax Court and the nature of the duties conferred on special trial judges.

The Tax Court is wholly a creature of Congress and its nineteen judges are appointed by the President and subject to Senate confirmation. 26 U.S.C. § 7443. Thus, the judges of the Tax Court are plainly principal officers within the meaning of Article II. Although the line between inferior and principal officers is far from clear and the Framers provided little guidance, *Morrison* v. *Olson*, 487 U.S. 654, 671 (1988), we find unpersuasive the Company's argument that the special trial judges are principal officers.

The Supreme Court in *Morrison* outlined four factors that must be examined to determine whether someone is a principal or an inferior officer: (1) the possibility of removal, (2) the scope of duties, (3) the scope of authority, and (4) the length of tenure. *Id.* at 671-72. In *Morrison*, the Supreme Court upheld the constitutionality of the provisions of the Ethics in Government Act of 1978, 28 U.S.C. §§ 591-599, which authorized the appointment of an independent counsel to investigate and to prosecute high

ranking government officials for violations of federal criminal laws. Specifically, in examining the statute's appointment provisions, the Court held that the independent counsel was not a "principal officer" under Article II. The Court, applying its four factor analysis, concluded that (1) the independent counsel was subject to removal by someone other than the President, (2) the duties of the office were limited, (3) the office's jurisdiction was restricted, and (4) the independent counsel's tenure was limited. *Id.*

Applying these criteria to the instant case, we conclude that a special trial judge is not a "principal officer." Special trial judges can be removed at anytime by the Chief Judge. The statute imposes no limitations on the power of the Chief Judge to remove any individual who is appointed as a special trial judge. The statute at issue narrowly circumscribes the authority of the special trial judges. Indeed, in a section 7443A(b)(4) proceeding, the findings of a special trial judge, although subject to deference, can only be made final when adopted by a Division of the Tax Court. *See* Tax Court Rule of Practice and Procedure 183(c). Finally, in view of the above, a special trial judge's tenure is necessarily limited.

This conclusion does not end our analysis. A special trial judge may still be an inferior officer and, therefore, remain subject to the appointment provisions of Article II. As the Supreme Court has stated, "any appointee exercising significant authority pursuant to the laws of the United States is an 'Officer of the United States,' and must, therefore, be appointed in the manner prescribed by § 2, cl. 2, of [Article II]." *Buckley*, 424 U.S. at 126. The Tax Court concluded that the special trial judges are

inferior officers. *First Western Securities*, 94 T.C. at 558-59. We agree.

Although the ultimate decisional authority in cases under section 7443A(b)(4) rests with the Tax Court judges, the special trial judges do exercise a great deal of authority in such cases. The special trial judges are more than mere aids to the judges of the Tax Court. They take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders. Contrary to the contentions of the Commissioner, the degree of authority exercised by special trial judges is "significant." *See Buckley*, 424 U.S at 126. They exercise a great deal of discretion and perform important functions, characteristics that we find to be inconsistent with the classifications of "lesser functionary" or mere employee. *Cf. Go-Bart Importing Co.* v. *United States*, 282 U.S. 344, 352 (1931) (United States commissioners are inferior officers).

3. *The Power to Appoint*

Having concluded that the special trial judges are "inferior Officers," we must now determine whether the Chief Judge of the Tax Court can constitutionally be vested with the power to appoint. The relevant language of the Appointments Clause bears repeating: "the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments." U.S. Const. art. II, § 2, cl. 2. Here, Congress clearly vested the Chief Judge of the Tax Court with the power to appoint special trial judges.[7]

[7] 26 U.S.C. § 7443A(a) provides:

> The chief judge may, from time to time, appoint special trial judges who shall proceed under such rules and regulations as may be promulgated by the Tax Court.

Although Congress has the authority to create offices and to provide for the method of appointment to those offices, "Congress' power . . . is inevitably bounded by the express language of Art. II, § 2, cl. 2, and unless the method it provides comports with the latter, the holders of those offices will not be 'Officers of the United States.'" *Buckley*, 424 U.S. at 138-39 (discussing Congress' power under the Necessary and Proper Clause). Therefore, the fundamental issue is whether the Appointments Clause empowers Congress to vest the Chief Judge of the Tax Court with the power to appoint special trial judges. Resolution of this question necessarily involves close scrutiny of the language of the Appointments Clause. In this case, it is beyond question that Congress had no intention of placing the power to appoint special trial judges in the President. We, therefore, are left with three other possibilities.

First, as the Company argues, we could conclude that the Tax Court is neither a "Court of Law" nor a "Department" within the meaning of Article II.[8] Under this scenario, the appointment power could not be vested constitutionally in the Chief Judge of the Tax Court. Second, as the Commissioner submits, the Tax Court could be treated as a department, with the Chief Judge as the duly authorized head of that department.[9] Third, as Amicus urges, the Tax Court

[8] The company's arguments implicitly recognize the existence of a "fourth branch" within our constitutional framework. *See generally* Strauss, *The Place of Agencies in Government: Separation of Powers and the Fourth Branch*, 84 Colum. L. Rev. 573 (1984).

[9] We note that in making this argument the Solicitor General, who is arguing on behalf of the Commissioner, abandoned the position that he advanced before the Tax Court

could be held to be a "Court of Law" within the meaning of Article II. In upholding the Chief Judge's authority to appoint special trial judges, the Tax Court adopted this third rationale. *First Western Securities*, 94 T.C. at 561-63.

The question of whether the phrase "Courts of Law," as it is used in the Appointments Clause, encompasses Article I courts is one of first impression. In examining this important question, therefore, we must focus primarily on the Constitution's language and structure. The existing Supreme Court precedent, however, does provide us with certain guideposts that can aid in our analysis.

4. *The Constitutional Framework*

Our inquiry into provisions of Article II necessarily requires us to analyze the very foundations of our system of government. In framing the Constitution, the Founding Fathers adopted a system of checks and balances to ensure that no one component of government would exercise too much power. To that end, "'[t]he Constitution sought to divide the delegated powers of the new Federal Government into three defined categories, Legislative, Executive, and Judicial.'" *Bowsher* v. *Synar*, 478 U.S. 714, 721 (1986) (quoting *INS* v. *Chadha*, 462 U.S. 919, 951 (1983)). As the Supreme Court has stated:

> The Framers provided a vigorous Legislative Branch and a separate and wholly independent Executive Branch, with each branch responsible

below. Previously, it had been argued that the Tax Court was a "Court of Law." The Solicitor General now submits that he changed his legal arguments after further study of the issue.

> ultimately to the people. The Framers also provided for a Judicial Branch equally independent with "[t]he judicial Power . . . extend[ing] to all Cases, in Law and Equity, arising under this Constitution, and the Laws of the United States."

Id. at 722 (quoting Art. III, § 2). This fundamental principle of separation of powers has for over 200 years protected the property and liberty of our nation's citizens. "The principle of separation of powers was not simply an abstract generalization in the minds of the Framers: it was woven into the document." *Buckley*, 424 U.S. at 124.

Although the Constitution sought to distribute power among the three branches, "the Framers did not require—and indeed rejected—the notion that the three Branches must be entirely separate and distinct." *Mistretta* v. *United States*, 488 U.S. 361, 380 (1989) (citations omitted); *see also Morrison*, 487 U.S. at 693-94 ("[W]e have never held that the Constitution requires that the three Branches of Government 'operate' with absolute independence.'"). Over the years, the Supreme Court has consistently recognized that in order to maintain an effective government our constitutional framework requires a certain degree of interdependence among the branches. *Buckley*, 424 U.S. at 121. The often quoted words of Justice Jackson emphasize this point:

> While the Constitution diffuses power the better to secure liberty, it also contemplates that practice will integrate the dispersed powers into a workable government. It enjoins upon its branches separateness but interdependence, autonomy but reciprocity.

Youngstown Sheet & Tube Co. v. *Sawyer*, 343 U.S. 579, 635 (1952) (concurring opinion).

Historically, separation of powers jurisprudence has focused on the extent to which one branch aggrandizes its power at the expense of another branch or encroaches on the authority specifically reserved for a co-equal branch. *Mistretta*, 488 U.S. at 412 (placement of independent sentencing commission in judicial branch does not undermine authority of executive or legislative branches); *Morrison*, 487 U.S. at 695-96 (no aggrandizement of power where judicial branch appoints independent counsel); *Bowsher*, 478 U.S. at 734 (Congress' retention of power to remove an officer performing executive functions results in aggrandizement of legislative power); *Chadha*, 462 U.S. 957-59 (one house legislative veto infringes on powers of executive). In each of these cases, the Supreme Court sought to balance the pragmatic concerns associated with the operation of an effective and efficient government with the institutional concern of remaining faithful to the fundamental governmental structure that the Framers incorporated into the Constitution. *See generally* Carter, *Constitutional Improprieties: Reflections on* Mistretta, Morrison, *and Administrative Government*, 57 U. Chi. L. Rev. 357 (1990) (deference to the governmental structure adopted by Framers is essential to maintenance of our constitutional framework and concerns of administrative convenience should not drive separation of powers analysis). The instant case requires us to struggle with these same competing principles. Although a pragmatic approach is often preferable, particularly where, as here, the potential for disruption to our constitutional scheme is minimal, we must be careful not to ignore the textual provisions of the Constitution and the principles they embody.

The principle of separation of powers is embedded in the Appointments Clause. *See Buckley*, 424 U.S. at 124-25; *but see* Blumoff, *Separation of Powers and the Origins of the Appointment Clause*, 37 Syracuse L. Rev. 1037, 1078 (1987) (Appointments Clause nothing more than the product of a political compromise and it should not be understood to reflect a consensus on the proper distribution of governmental power). That clause designates three repositories in which the Congress can place the power to appoint: "in the President alone, in the Courts of Law, or in the Heads of Departments." U.S. Const. art. II, § 2, cl 2. Thus, the Appointments Clause only vests Congress with the authority to distribute the appointment power; Congress cannot reserve for itself the power to appoint. *See Buckley*, 424 U.S. at 132-33. Similarly, Congress cannot reserve for itself the power to remove the appointee. *Bowsher*, 478 U.S. at 726. Of the three potential repositories of the appointment power, two—the President and heads of departments—are in or at least connected with the Executive Branch, *id.* at 127, and the remaining one—"Courts of Law"—has been interpreted to be in "the Judiciary." *Id.* at 132.

With these fundamental principles in mind, we direct our attention to the Company's specific challenge: Can the Chief Judge of the Tax Court constitutionally be vested by Congress with the power to appoint?

(a) *Court of Law*

The Company and the Commissioner assert that Article II's reference to "Courts of Law" is necessarily limited to courts created pursuant to Article III and that, therefore, the Chief Judge of the Tax Court, a

non-Article III judge, constitutionally cannot be vested with the power to appoint under this designation. *Amicus* argues that this is too narrow a reading of Article II. He submits that the phrase "Courts of Law" means any court authorized by Congress to adjudicate cases.[10] *Amicus* points out that Article I confers on Congress the power "[t]o constitute Tribunals inferior to the supreme Court." U.S. Const. art. I, sec. 8, cl. 9. All the parties acknowledge that the creation of such "legislative courts" is constitutionally valid. *See Crowell* v. *Benson*, 285 U.S. 22, 50-51 (1932) (under Article I Congress can establish courts to adjudicate public rights—rights which arise between governmental agencies and the citizens subject to the authority of these bodies); *Bakelite*, 279 U.S. at 451 (legislative courts may be used to determine matters that "do not require judicial determination and yet are susceptible of it"); *American Ins. Co.* v. *Canter*, 26 U.S. (1 Pet.) 511, 546 (1828) (Congress has the authority under Article I to create territorial courts that are not vested with the "judicial power" defined in Article III). *Amicus* goes one step further, however, and asserts that there can be little doubt that these Article I courts are "Courts of Law" within the meaning of Article II. In support of this proposition, *Amicus* points to the functions performed by the Tax Court and Congress' history of

[10] The task of navigating through the murky waters that surround this area of constitutional law is a difficult one. As the Supreme Court has recognized, a concise and direct analysis of the issues surrounding the distinctions between Article III and Article I courts is extremely difficult because this area of constitutional law is plagued by "frequently arcane distinctions and confusing precedents." *Northern Pipeline Constr. Co.* v. *Marathon Pipe Line Co.*, 458 U.S. 50, 90 (1982) (Rehnquist, J., concurring).

vesting Article I courts with the authority to appoint certain officers. We reject *Amicus'* arguments.

The provisions of Article II incorporate the principle of separation of powers, permitting the Congress to place the appointment power in the President, a head of department, or the "Courts of Law." The Constitution also gives the Congress a direct role in the appointments process by requiring the advice and consent of the Senate for the appointment of principal officers.

In identifying the "Courts of Law" as a potential repository of the appointment power, there is no indication that the Framers contemplated any courts other than provided for under Article III. Indeed, Article III contains the Constitution's only other use of the term "courts." Moreover, in interpreting the Appointments Clause, the Supreme Court has declared that inferior officers can be appointed only by "the President alone, by the heads of departments, or by the *Judiciary.*" *Buckley*, 424 U.S. at 132 (emphasis added). The Supreme Court's consistent use of the term "Judiciary" emphasizes that Article II's reference to "Courts of Law" solely encompasses Article III courts. "The Federal Judiciary was . . . designed by the Framers to stand independent of the Executive and Legislature—to maintain the checks and balances of the constitutional structure, and also to guarantee that the process of adjudication itself remained impartial." *Northern Pipeline Constr. Co.* v. *Marathon Pipe Line Co.*, 458 U.S. 50, 58 (1982) (plurality opinion). The term "Judiciary" refers exclusively to those judges appointed in conformity with the requisites of Article III—life tenure and no diminution of salary. *Id.* at 59-60 & n.10. Only courts that possess the attributes prescribed in Article III can exercise

the "judicial power" of the United States. *Id.* at 59. Although the Supreme Court has subsequently clarified certain statements made by the plurality in *Northern Pipeline, see Thomas* v. *Union Carbide Agric. Products Co.*, 473 U.S. 568, 584-86 (1985), the Court has not undermined the proposition that the term "Judiciary" refers exclusively to Article III courts.[11]

In pressing the argument that the Tax Court is a Court of Law, *Amicus* emphasizes that in several instances Congress has vested Article I courts with the power to appoint. For example, Congress vested several territorial and specialized courts with the power to appoint inferior officers—such as clerks and commissioners. *See* Act of June 4, 1812, ch. 95, § 10, 2 Stat. 743, 746 (giving Missouri territorial court the power to appoint a clerk); Act of May 2, 1890, ch. 182, § 9, 26 Stat. 81, 86 (Oklahoma) (same); Act of

[11] Although Congress plainly has the authority under Article I to create legislative courts, such as the Tax Court, it is equally clear that such courts lack the requisites of Article III status. The cases which have recognized the legitimacy of legislative courts have been careful to distinguish such courts from "constitutional courts, in which the judicial power conferred by the constitution on the general government, can be deposited." *American Ins. Co.* v. *Canter*, 26 U.S. (1 Pet.) 511, 546 (1828); *see also Ex Parte Bakelite Corp.*, 279 U.S. 438, 449-50 (1929); *Crowell* v. *Benson*, 285 U.S. 22, 50 (1932). The Court's recent reluctance to make any definitive statements regarding the jurisdictional tension between Article III and Article I courts does not undermine the fundamental proposition that Article I and Article III courts stand on a different constitutional footing. *See Thomas* v. *Union Carbide Agric. Products Co.*, 473 U.S. 568, 585-87 (1985); *see generally* Note, *Formalism and Functionalism: From Northern Pipeline to Thomas v. Union Carbide Agricultural Products Co.*, 37 Syracuse L. Rev. 1003 (1986).

June 6, 1900, ch. 786, § 6, 31 Stat. 321, 323 (Alaska) (same); Act of Feb. 24, 1855, ch. 122, §§ 3, 11, 10 Stat. 612, 613-14 (vesting Claims Court, which at the time was considered an Article I court, with power to appoint commissioners and a clerk). *Amicus* asserts that this tradition establishes that such bodies are "Courts of Law" within the meaning of the Appointments Clause. While we view this historical practice to be evidence that Article I courts can constitutionally be vested with the power to appoint, we do not believe that it necessarily establishes that such courts are permitted to be vested with this power because they are "Courts of Law" under Article II. *See Mistretta*, 488 U.S. at 401 ("'traditional ways of conducting government . . . give meaning' to the Constitution") (quoting *Youngstown Sheet & Tube*, 343 U.S. at 610) (concurring opinion)). It is equally probable, as we discuss *infra*, that these Article I courts were viewed as a department. In any event, Congress' vesting these "courts" with the power to appoint does not make the placement of that power necessarily constitutional.

Amicus encourages us to treat as secondary the formal constitutional distinctions between Article I and Article III. Instead, he suggests focusing on the functions performed by the Tax Court. *Amicus* reasons that because the Tax Court adjudicates disputes it must therefore be a "Court of Law." We do not dispute *Amicus*' factual assertions. Indeed, we acknowledge that the Tax Court performs many functions similar to those performed by Article III courts. The judges of the Tax Court hear evidence, make rulings, review briefs, and render opinions that are binding on the parties and appealable to the Court of Appeals. These facts, however, do not necessarily

lead to the conclusion that the Tax Court is a "Court of Law" as the term is used in the Appointments Clause. It is not enough merely to focus on the nature of the function being performed. *See Mistretta*, 488 U.S. at 386. Very often administrative agencies that are in or associated with the executive branch perform adjudicatory functions. *See Schor*, 478 U.S. at 850-854. One need only consider the operation of the Social Security Administration to recognize that our system of government is replete with instances of administrative agencies performing adjudicatory functions. *See, e.g., Mathews* v. *Eldridge*, 424 U.S. 319 (1976). As Justice Brandeis once explained, the principle of separation of powers "left to each [Branch] power to exercise, in some respects, functions in their nature executive, legislative and judicial." *Myers* v. *United States*, 272 U.S. 52, 291 (1926) (dissenting opinion). Certainly administrative agencies are not "Courts of Law," as that term is used in Article II, simply because they perform adjudicatory functions. A purely functional analysis, however, fails adequately to consider the importance of the Constitution's framework and often would lead to untenable results.

Despite the functional nature of the Tax Court and the fact that Article I courts historically have been vested with the power to appoint, we conclude, in light of the language of the Appointments Clause and the structure of the Constitution, that the Tax Court is not a "Court of Law" within the meaning of Article II.

(b) *Department*

Having concluded that the Tax Court is not a "Court of Law" within the meaning of the Appointments Clause, we must now determine whether the

Tax Court is a "department" of which the Chief Judge is the "head," an argument advanced by the Commissioner but rejected by both the Company and *Amicus*. We find the argument advanced by the Commissioner to be persuasive.

We begin by repeating that the nature of the duties performed by an office does not determine where the appointment power for such an office can be properly placed. For instance, an officer's performance of traditionally recognized executive functions—such as prosecution—does not mean that he or she must be appointed by the executive. *See Morrison*, 487 U.S. at 675-77 (power to appoint special prosecutor can be vested in Article III court). As the Supreme Court has counselled, we should not give undue emphasis to the nature of the duties assigned to a particular office.

> It is no doubt usual and proper to vest the appointment of inferior officers in that department of the government, executive or judicial, or in that particular executive department to which the duties of such officers appertain. But there is no absolute requirement to this effect in the Constitution; and, if there were, it would be difficult in many cases to determine to which department an office properly belonged.

Ex Parte Siebold, 100 U.S. 371, 397 (1880). The question where to place the Tax Court in our constitutional scheme leads us to an examination of the history of the Tax Court.

The United States Tax Court was originally established by an Act of Congress in 1924 as the Board of Tax Appeals and was designated as "an independent agency in the executive branch of the Government." Revenue Act of 1924, ch. 234. § 900(a), (k), 43 Stat. 336, 338. In 1942, Congress changed the

name of the Board of Tax Appeals to the "Tax Court of the United States." Revenue Act of 1942, ch. 619, § 504, 56 Stat. 798, 957. Its designation as an independent agency within the Executive Branch, however, was not changed. Indeed, this designation continued until Congress enacted the Tax Reform Act of 1969, P.L. 91-172, tit. IX, § 951, 83 Stat. 487, 730 (codified as amended at 26 U.S.C. § 7441). That provision provided:

> There is hereby established, under article I of the Constitution of the United States, a court of record to be known as the United States Tax Court.

Id. Congress' passage of the 1969 Tax Reform Act renaming this adjudicatory body the United States Tax Court does not in itself lead to the conclusion that Congress removed this body entirely from the Executive Branch. Likewise, we do not find the legislative history to indicate definitely where in our constitutional scheme Congress intended to place this adjudicatory body. The legislative history regarding the Tax Act of 1969 is rather limited. The Senate Report does demonstrate that Congress intended to cease classifying the Tax Court as an agency within the Executive branch. S. Rep. No. 552, 91st Cong., 1st Sess. 301, *reprinted in* 1969 U.S. Code Cong. & Admin. News 2027, 2340-41. While it is clear that Congress intended to establish a "court" pursuant to its Article I authority, it is equally apparent that Congress realized that this Article I forum lacked the requisites of Article III status. *See generally id.* at 2343 n.3. The source from which the Chief Judge's appointment power was to be derived, however, is unclear. The lack of congressional clarity on the specific issue now before us is not surprising. Since the

New Deal era, the "administrative state" has become an accepted and necessary element of our government. As yet, our constitutional precedent has failed to address specifically all the ramifications that stem from the continuing evolution in our governmental structure. For the reasons that we discuss *infra*, we believe that Congress' desire to create a "court" is not inconsistent with the conclusion that for purposes of the Appointments Clause the Tax Court is a department associated with the Executive branch.

Several factors lead us to conclude that the Tax Court remains a department associated with the Executive Branch. First, in examining the Founders' use of the phrase "Heads of Departments," the Supreme Court has explained: "The phrase 'Heads of Departments' used as it is in conjunction with the phrase 'Courts of Law,' suggests that the Departments referred to are themselves in the Executive Branch or at least have some connection with that branch." *Buckley*, 424 U.S. at 127. This explanation is particularly applicable to the Tax Court. The Tax Court serves as a forum to challenge tax deficiencies as determined by the Commissioner. The Internal Revenue Service is clearly within the province of the Executive Branch, specifically the Department of Treasury. Thus, in this respect, it can be said that the Tax Court "has some connection with [the Executive Branch]." This conclusion is further supported by Congress' decision to place the predecessor to the Tax Court in the Executive Branch. In adopting the 1969 amendments, Congress explained: "The United States Tax Court established under the amendment made by section 951 is a continuation of the Tax Court of the United States as it existed prior to the date of enactment of this Act." Tax Reform A

of 1969, P.L. 91-172, tit. IX, § 961, 83 Stat. 487, 735. Thus, Congress did little more than change the label to be used when referring to this alternative forum for the resolution of tax disputes. We do not think that the label that Congress chooses to give an adjudicatory body determines its constitutional status. To so hold would render many of the Constitution's provisions superfluous.

Second, it is well established that Congress can provide for the adjudication of "public rights" in Article I courts. Public rights are those rights that arise "between the Government and persons subject to its authority in connection with the performance of the constitutional functions of the executive or legislative departments." *Crowell*, 285 U.S. at 50. The "public rights doctrine" has its basis in the principle of separation of powers, and the "historical understanding that certain prerogatives were reserved to the political Branches of Government." *Northern Pipeline*, 458 U.S. at 67. Indeed, the rationale underlying this understanding is that since Congress would be free to commit such matters exclusively to the executive branch for resolution, Congress can employ "the less drastic expedient of committing their determination to a legislative court or an administrative agency." *Id.* at 68. As the Supreme Court has summarized:

> In essence, the public rights doctrine reflects simply a pragmatic understanding that when Congress selects a quasi-judicial method of resolving matters that "could be conclusively determined by the Executive and Legislative Branches," the danger of encroaching on the judicial powers is reduced.

Thomas, 473 U.S. at 589 (quoting *Northern Pipe-Line*, 458 U.S. at 68).

The Tax Court is the classic example of a forum that adjudicates "public rights." The relationship between the government and taxpayer plainly gives rise to public rights and we have no doubt that the resolution of such disputes can be relegated to a non-Article III forum. *Crowell*, 285 U.S. 50-51; *Bakelite*, 279 U.S. 450-51; *Murray's Lessee* v. *Hoboken Land & Improvement Co.*, 59 U.S. (18 How.) 272, 284 (1856).

The "public rights" doctrine rests on the premise that any matters subject to adjudication in Article I forums could have been conclusively determined by the executive or legislative branches in the first instance. *See Thomas*, 473 U.S. at 589; *Northern Pipeline*, 458 U.S. at 67-69; *Bakelite*, 279 U.S. at 451-53; *see also* Strauss, *supra* note 6, at 632 ("the whole point of the [traditional] 'public rights' analysis" has been "that *no judicial involvement at all* was required—executive determination alone would suffice"). Given the fact intensive nature of tax disputes, resolution of such claims would ordinarily be left to the executive. *See* Redish, *Legislative Courts, Administrative Agencies, and the Northern Pipeline Decision*, 1983 Duke L.J. 197, 213 (1983) (summary). Thus, we find it entirely consistent with the reasoning underlying the "public rights" doctrine to treat the Tax Court as a department associated with the executive branch.

Third, legislative courts, such as the Tax Court, share many of the characteristics of administrative agencies. We believe that the work performed by legislative courts and adjudicatory agencies cannot be distinguished. *Id.* at 201. Both are bodies created by Congress under Article I to adjudicate federal rights and both lack the requisites of Article III status.

"[F]rom the perspective of Article III, [there is] no difference in constitutional principle between legislative courts and administrative agencies." Fallon, *Of Legislative Courts, Administrative Agencies, and Article III*, 101 Harv. L. Rev. 915, 928 (1988) (citations omitted); *see also Northern Pipeline*, 458 U.S. at 113 (White, *J.*, dissenting) (noting that many Article I courts "go by the contemporary name of 'administrative agencies'"); Sommer, *Independent Agencies as Article One Tribunals: Foundations of a Theory of Agency Independence*, 39 Admin. L. Rev. 83, 98-100 (1987) (advocating treating independent agencies as Article I courts, yet recognizing that the constitutional status of both remains unclear); Miller, *Independent Agencies*, 1986 Sup. Ct. Rev. 41, 50 (noting that the term "independent agency" has never been conclusively defined and that Article I courts can properly be categorized in this manner); Redish, *supra*, at 201 ("Court cannot logically distinguish the work of non-Article III legislative courts from that of administrative adjudicatory bodies. Despite several differences in both appearance and operation, their work cannot be functionally or theoretically distinguished."). As one scholar has aptly explained:

> The members of administrative agencies do not wear robes or retain the other traditional indicia of judicial office. Nevertheless, these agencies are analogous to legislative courts because, although they may and often do perform adjudicatory functions, their members do not receive the salary and tenure protections of Article III.

Redish, *supra*, at 214. We, therefore, think it entirely consistent with the text of the Constitution and the existing precedent to treat Article I creatures, like

the Tax Court, as departments, particularly where as here the matters being adjudicated could have been left to executive resolution.

Fourth, historically when analyzing Appointments Clause arguments, the Supreme Court has focused its attention on the question of which branch retains the authority to remove a particular officer. *See, e.g., Bowsher*, 478 U.S. at 724-26; *Weiner* v. *United States*, 357 U.S. 349 (1958); *Myers* v. *United States*, 272 U.S. 52 (1926). Here, the judges of the Tax Court are appointed by the President and removable by him, albeit only "after notice and opportunity for public hearing, for inefficiency, neglect of duty, or malfeasance in office, but for no other cause." 26 U.S.C. § 7443(f); *compare* U.S. Const. art. III, § 1 (Article III judges serve during "good Behavior"). Thus, although insulated to a large extent, the judges of the Tax Court ultimately remain answerable to the President and are not wholly divorced from his oversight. In this regard, the analogy between the Tax Court and administrative agencies becomes even stronger. The principal officers of some agencies are presidentially appointed and serve for a term of years and are not removable at the will of the President. *See Humphrey's Executor* v. *United States*, 295 U.S. 602 (1935) (holding that Congress can limit the President's removal power over independent agencies). While not having been subject to constitutional challenge, the principal officers of such independent agencies have been presumed to be proper repositories of the appointment power. *See, e.g.*, 7 U.S.C. § 4a(e) (vesting the members, including the chairman, of the Commodities Future Trading Commission with the power to appoint); 15 U.S.C. § 78d(b) and Reorganization Plan No. 10 of 1950, effective May 24,

1950, 15 F.R. 3175, 64 Stat. 1265 (placing the power to appoint in the chairman of the Securities and Exchange Commission). Although such agencies have been deemed to be "independent" of the executive, they remain affiliated with the executive branch. *See generally* Note, *Incorporation of Independent Agencies into the Executive Branch*, 94 Yale L.J. 1766 (1985) (arguing for increased executive control over "independent agencies"). Adopting the pragmatic approach endorsed by the Supreme Court in *Mistretta*, *Thomas* and *Morrison*, we conclude that legislative courts, like administrative agencies, are for purposes of the Appointments Clause most appropriately characterized as "departments" associated with the executive branch.

Finally, section 7443A places the power to appoint special trial judges in the Chief Judge of the Tax Court. 26 U.S.C. § 7443A(a). Congress chose to place the power in a specified office and not in the Tax Court itself. *Compare* 28 U.S.C. § 631(a) (placing power to appoint United States magistrates in all of the judges of each United States District Court); 28 U.S.C. § 152 (vesting United States Court of Appeals with the power to appoint bankruptcy judges). Clearly Congress knows how to place the appointment power in a judicial body as opposed to a particular office. Although not in itself definitive, we conclude that the decision by Congress to vest the Chief Judge, a particular office, instead of the Tax Court itself, with the power to appoint, further supports the conclusion that the Tax Court is a "department" and the Chief Judge is the "head" of that department for purposes of the Appointments Clause.

Arguing on behalf of the commissioner, the Solicitor General, in response to one of our questions, frankly

acknowledged that the day-to-day operations of government would not be impacted negatively if we were to conclude that the Tax Court was a "Court of Law." This concession alone, however, cannot lead us to ignore the Constitution and the existing precedent. While the issue before us is not susceptible to easy analysis, we are convinced that our holding is consistent with the nation's constitutional framework and the practical considerations of managing the operations of our contemporary government.

CONCLUSION

Our review of the language and legislative history of section 7443A of Title 26 leads us to conclude that Congress, when it used the phrase "any other proceeding," intended to authorize the assignment of complex tax cases that involve large amounts in controversy to special trial judges. We also hold that the Tax Court is a "department" with the Chief Judge as its "head" within the meaning of the Appointments Clause. In reaching this latter result, we have sought to balance the competing values of remaining loyal to the Constitution's framework and the pragmatic concerns of effectively governing this nation. In sum, we hold that section 7443A is not constitutionally infirm. Our opinion should not be read to cast a shadow on the constitutional legitimacy of Article I courts. The constitutionality of such forums is undoubted. Rather, our decision stands for the limited proposition that the Tax Court is not a "Court of Law" within the meaning of the Appointments Clause, but is instead a department associated with the executive branch. Accordingly, we affirm the decision of the Tax Court, but on a different rationale.

☆ U. S. GOVERNMENT PRINTING OFFICE, 1991 282061 20461

Supreme Court, U.S.
FILED
APR 16 1991
OFFICE OF THE CLERK

No. 90-762

IN THE
Supreme Court of the United States
OCTOBER TERM, 1990

THOMAS and SHARON FREYTAG, *et al.*,
Petitioners,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

PETITIONERS' REPLY BRIEF

KATHLEEN M. SULLIVAN
Counsel of Record
BRIAN STUART KOUKOUTCHOS
1525 Massachusetts Avenue
Cambridge, MA 02138
(617) 495-4633
RICHARD J. SIDEMAN
MARTHA A. BOERSCH
SIDEMAN & BANCROFT
One Embarcadero Center
Suite 860
San Francisco, CA 94111
(415) 392-1960
Counsel for Petitioners

April 16, 1991

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

TABLE OF CONTENTS

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES—Continued

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-762

THOMAS and SHARON FREYTAG, *et al.*,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

PETITIONERS' REPLY BRIEF

INTRODUCTION

The government concedes that the language of the Tax Court's rules implementing its statutory authority in cases under 26 U.S.C. § 7443A(b)(4) is "not ideal" (Government's Brief "GB" 19), and that the Tax Court's supposed fit within the Executive Branch is "not . . . perfect." (GB 41). But the problem here is far graver than inadequate phrasing or imperfect fit. When, as in this case, a special trial judge effectively decides a (b)(4) case, he acts with neither congressional nor constitutional mandate.

To avoid the force of petitioners' statutory argument, the government asks this Court to hypothesize a secret and unrecorded Tax Court procedure, inaccessible to the parties, that is unmentioned in the record below or in any Tax Court Rule or decision. Active and searching oversight of special trial judges in (b)(4) cases is in fact precluded by the Tax Court's own rules: parties

have no opportunity to see or file exceptions to a special trial judge's report, and once that report is filed with the Tax Court, Rule 183(c) provides that its factual findings "shall be presumed to be correct." Congress did not and cannot have intended to establish such a regime.

To avoid the force of petitioners' constitutional argument, the government invokes a parade of horribles not remotely presented by this case—the supposed disruption of appointments in the "50 free-standing agencies of the Executive Branch." (GB 46). But Article I courts are the sole entities whose appointment power is at issue here, and these wholly adjudicatory entities are uniquely lacking in the attribute the Framers deemed essential to exercise of the appointment power: protection from Congress, either through the political muscle of the President or the independence of the Article III judiciary. In order to rule that the Article I Tax Court is not an "Executive Department," and hence may not be vested with the power to appoint inferior officers, this Court need not issue any advisory opinions about the possible existence and constitutional status of a headless "Fourth Branch" of government.

I. THE STATUTORY VIOLATION

1. The linchpin of the government's interpretation of 26 U.S.C. § 7443A(b)(4) is that this category of special trial judge jurisdiction is readily distinguishable from subsections (b)(1) to (3) because Congress denied special trial judges the authority to make the judgment of the Tax Court in (b)(4) cases. Yet the government defends the judgment below in the face of a record demonstrating the passive adoption of the special trial judge's report by the regular Tax Court judge, who entered the report as his own opinion with the sole addition of his signature. Such rubber-stamping is not authorized by the statute and cannot have been Congress' intent.[1]

[1] The government asserts that whether Congress authorized the Tax Court to allow special trial judges to "'effectively resolve'" (b)(4) cases was not presented in the Petition for Certiorari. (GB 17). This is absurd: the first Question Presented raises the issue of "effective resolution" *in haec verba*.

2. The government agrees that, "[b]y statute, a special trial judge has no authority to decide a case assigned under [(b)(4)]." (GB 17). The difference between us is that petitioners believe that "making the decision" requires the Tax Court to scrutinize the special trial judge's report, review the record, apply law to fact, and make appropriate modifications, whereas for the government, "making the decision" is satisfied so long as the opinion is formally "issued by the Tax Court in the name of" a regular Tax Court judge." (A7) (GB 18 n.9). In stark contrast to the pre-1984 practice that the government claims Congress meant to codify in subsection (b)(4),[2] the Tax Court opinion here contains no

[2] The government's own authorities (GB 14 n.8) conclusively establish that Tax Court review of cases assigned under the pre-1984 practice that Congress supposedly codified was the *opposite* of the rubber-stamping that is now conducted under § 7443A(b)(4). *All* of those cases were decided under a now-superseded rule that provided that any report by a special trial judge was to be served on the parties who could then file briefs and objections with the regular Tax Court judge, who had to take them into account in scrutinizing the record and adapting the special trial judge's report before he made his decision. *See* former Tax Court Rule 182(b) & (c) (1979). *See Estate of Wheeler v. Comm'r*, 37 T.C.M. (CCH) 51 (1978) (special trial judge merely presided over trial; findings of fact and opinion were written by *a regular Tax Court judge*); *Estate of Thurner v. Comm'r*, 37 T.C.M. (CCH) 981, 981 (1978) (report modified "after considering the entire record herein, the briefs of the parties, petitioners' exception to the special trial judge's report, and respondent's reply thereto."); *Perrett v. Comm'r*, 74 T.C. 111, 135-36 (1980) (report modified after taxpayers' objections were specifically addressed and given "careful consideration").

But old Rule 182 was amended, effective 1984 (the year § 7443A(b)(4) was enacted), to delete this procedure. *See* 81 T.C. 1045, 1069. The present practice under Rule 183(c) does not ensure that a regular Tax Court judge in fact critically reviews the report of a special trial judge before adopting it. This supervisory

hint of review of the transcripts or exhibits, no discussion of the parties' arguments, no suggestion of any critique or modification of the special trial judge's report—just the single sentence "The Court agrees with and adopts the opinion of the special trial judge that is set forth below," followed by a copy of that report. (A14).

Although this procedure is not consistent with either the statutory design or congressional intent, it is perfectly consistent with Tax Court Rule 183(c), which mandates that the special trial judge's findings "shall be presumed to be correct." (A92). The government admits that "the phrasing of this sentence is not ideal" (GB 19), but nevertheless insists that this language somehow includes a duty of *de novo* review by the Tax Court. Actually, the language of Rule 183(c) is clear enough: it precludes the possibility of the *de novo* review that the government would have this Court believe actually takes place in the Tax Court. *Stone v. Commissioner*, 865 F.2d 342, 344-47 (D.C. Cir. 1989). (*See* Petitioners' Brief "PB" 21 & n.32). The decision below was "made" by the special trial judge; *all* that was before the Fifth Circuit on appeal from the Tax Court was the special trial judge's findings of fact and conclusions of law.

3. The government asks this Court to presume administrative regularity in this case. (GB 18 n.9). But if we presume that the Tax Court operated in accord with its own published rules and that the record in this case accurately reflects the procedures followed, then the government's statutory argument is doomed. For that would mean (1) that, in accord with Rule 183(c), the special trial judge's report was in fact "presumed correct" rather than reviewed *de novo*; (2) that we must take at face value the Tax Court's statement here that *all* it did was "agree with and adopt the opinion of the special trial judge" (A14); (3) that we must accept what the Fifth Circuit's decision (A8) and the Tax Court docket entries confirm—that the special trial judge's report was adopted verbatim the moment it was filed with the Tax Court. (PB 8-9, 23-24). If this is in fact what took place, the government agrees that § 7443A was violated. (GB 17).

regime contrasts sharply with that governing the work of federal magistrates, whose findings of fact and conclusions of law—and even their rulings on pretrial motions—are all subject to *de novo* review if any party files objections. (*See* PB 28).

Instead of evidence to support any other version of the events below, the government offers only speculation about a supposed vague procedure, unmentioned in the statute, Tax Court rules, or any Tax Court decision, and unreflected anywhere in the record below. As the government would have it, the Chief Judge obtained the report, the 9,000 page transcript, the 3,000 exhibits and the 200 hours of videotaped testimony from the special trial judge, gave them careful study, and modified the report as necessary before that report was even filed with the Tax Court. (GB 18 n.9). The government thus asks this Court to presume *administrative regularity* in these proceedings, *id.*, while suggesting that Tax Court review of the report took place in an unrecorded and *administratively irregular* manner—indeed, in a manner that appears to violate the procedural sequence spelled out in Tax Court Rule 183(b) & (c). No such inference is remotely plausible.[3]

[3] Not only is there no trace of this hypothetical preview procedure in the record of this case or in any Tax Court rule, it is equally absent from the cases cited by government. (GB 18 n.9) It appears from the Tax Court's opinion in each of those cases, as it does here, that the special trial judge's report was adopted without discussion or modification. And the docket entries that the government cites, like those in this case, confirm that the special trial judge's report was filed with the Tax Court and adopted the very same day.

II. THE APPOINTMENTS CLAUSE VIOLATION

A. Special Trial Judges Are Not Ministerial Employees.

1. Every court to address the issue has held that special trial judges are inferior officers. *See* A79-80 (Tax Court); *Samuels, Kramer & Co. v. Comm'r*, Nos. 90-4060/4064 (2d Cir. April 2, 1991) (Reprinted as an appendix to the Government's Supplemental Brief ("GSB App.") at 21a). Indeed, even the government seems to agree that special trial judges are inferior officers, for it argues only that "a special trial judge assigned under 26 U.S.C. § 7443A(b)(4) performs duties that *may* be performed by an employee not subject to the Appointments Clause." (GB 28) (emphasis added). Since Congress supposedly *could have* provided that petitioners' cases be assigned to a mere employee, we are told that petitioners may not complain that they were *in fact* assigned to an improperly appointed inferior officer. That is like saying that, if petitioners had gone to an Article III district court to litigate the disputed tax, the fact that the district judge had been appointed without the advice and consent of the Senate would raise no Appointments Clause issue because Congress could have left the resolution of such tax disputes entirely to executive officers anyway. (*Cf.* GB 35). This theory will not do—regardless of what Congress *might* have done, it made special trial judges inferior officers without providing for constitutional appointment.

2. The government next reasons that special trial judges may be deemed mere employees in (b)(4) cases such as this one because they lack formal authority to enter a final decision. (GB 28-31). But, as the Second Circuit has just held in the related case of *Samuels, Kramer & Co. v. Comm'r*, "special trial judges are more than mere aids . . . They take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders. . . . They exercise a great dealt of discretion and perform important functions, characteristics that we find inconsistent with the classifications 'lesser functionary' or mere employee." (GSB App. 21a). Under the government's reasoning, federal magistrates would be mere employees doing insignificant tasks when they conduct felony jury voir dire, conduct suppression hearings, or decide pretrial and discovery motions, since those acts do not involve a final decision.[4]

B. The Tax Court is Not a "Court of Law."

There is one issue on which petitioners are in complete agreement with the government: the Article I Tax Court cannot be deemed a "Court of Law" within the meaning of the Appointments Clause, for in that clause the Framers used "Courts of Law" to denote those courts constituted in accord with Article III. (GB 35-38). Indeed, even the *amicus* affirmatively endorses the proposition that when the "Founding Fathers intended to limit" a clause of the Constitution "to Article III courts, they . . . used the word 'Courts,' as used in Article III, rather than the broader word 'Tribunals.'" Brief of *Amicus Curiae* ("Am.B") at 3 n.2. The entire argument of the *amicus* proceeds from the misapprehension that petitioners and the government somehow challenge the

[4] The government also ignores the fact that the "distinction between officer and employee in this connection does not rest upon . . . the character of the service to be performed. [It] . . . is determined by the manner in which Congress has specifically provided for the creation of the several positions, their duties and appointment thereto." *Burnap v. United States*, 252 U.S. 512, 516 (1920). The office of special trial judge is "established by Law," Art. II, § 2, cl.2, and the duties, salary and means of appointment for that office are specified by statute. (PB 27-28). This distinguishes special trial judges from special masters hired by the Article III courts on a temporary, episodic, *ad hoc* basis, whose positions are not established by law, and whose duties and functions are not spelled out by Congress in a statute. *See Burnap*, 252 U.S. at 516-17; *United States v. Germaine*, 99 U.S. (9 Otto) 508, 511-512 (1879); *United States v. Maurice*, 26 Fed.Cas. 1211, 1214 (No. 15,747) (1823) (Marshall, C.J.).

legitimacy of Article I tribunals. (Am.B 18). But all that is at issue is the status of Article I tribunals under the Appointments Clause, and as to *that* issue the *amicus* (Am.B 24), like the government (GB 46-47), offers what is in essence an extra-constitutional appeal to governmental convenience—an appeal this Court has never hesitated to reject when the Constitution's textual commands are at stake. *See, e.g., INS v. Chadha*, 462 U.S. 919, 963 (1983).

C. The Tax Court Is Not An Executive "Department."

1. The government's ultimate rationale for deeming the Tax Court an Executive "Department" is the fear that any other holding might threaten whatever appointment power may be vested in independent commissions like the FTC and in other "free-standing" executive agencies not affiliated with a Cabinet Department. (GB 46-47). Aside from the fact that solicitude for government convenience is never sufficient to override the Constitution's textual commands, this particular scare tactic is a red herring. Only the *Tax Court's* appointment power is at issue here. Significantly, the government does not quarrel with the fact that the elimination of the Chief Judge's power to appoint special trial judges, or its transfer to the President, would not impair the operations of the Tax Court. (PB 37-38 & nn. 34, 35). Instead, the government proceeds as if the decision in this case necessarily would govern independent commissions and other "free-standing agencies of the Executive Branch." (GB 46).[5]

[5] The government does not even suggest that any significant disruption of other Article I tribunals would ensue from denying Congress the freedom to vest them with appointment power. Only Claims Court vaccine masters would be threatened, and the President has already asserted that their appointment violates the Constitution. (PB 40-41; GB 29-30 n.24). Currently, "appointments" by other Article I courts are limited to employees. *See, e.g.*, 38 U.S.C. § 4081 (Court of Veterans Appeals may name its own court clerk, law clerks, and secretaries). None of these positions is further defined by law and the holders thereof must be considered employees rather than "officers of the United States." The government also seems to agree that the territorial courts are not subject to the separation of powers principle embodied in the Appointments Clause. (GB 36 n.28; PB 35-36 n.33).

The government is coy about the nature and extent of this "threat," declining to inform this Court as to (1) which, if any, of these agencies harbor "offices established by Law" to which inferior officers must be appointed, and what those offices might be,[6] (2) which, if any, of the heads or chiefs of those agencies are empowered by Congress to appoint inferior officers, and (3) precisely how the elimination of such appointment power, or a transition to appointments by the President himself, would adversely affect federal operations.[7] In any event, the

[6] Joseph Story's statement that inferior officers outnumbered principal officers among the "lucrative offices" of the federal government in 1833 (GB 47) does not speak to the relevant issue. As this Court noted as early as 1879, a person "may be an agent or employee working for the government and paid by it, as nine-tenths of the persons rendering service to the government undoubtedly are, without thereby becoming its officers." *Germaine*, 99 U.S. at 509.

[7] The incremental burden on the President of naming 14 special trial judges would scarcely be noticed. According to the Office of Presidential Personnel, Executive Office of the President (May, 1989), Congress already requires that more than 2,000 inferior officers in the lower echelons of the Executive Departments, regulatory commissions and independent agencies be appointed by the President alone or with the advice and consent of the Senate. In actual practice, even when formal appointment power is lodged in the President or a Department Head, lower agency and Department officials routinely select their own subordinates, whose appointments are forwarded to the Office of Presidential Personnel for review and approval.

This practice accords with the Framers' intent. When James Madison objected that the proposed Appointments Clause was too cumbersome, and that "Superior Officers" other than "Heads of Departments ought in some cases to have the appointment of the lesser offices," Gouverneur Morris replied, "There is no necessity. Blank commissions can be sent." 2 M. Farrand, *The Records of the*

issue of the independent agencies' appointment power *vel non* can be left to law review commentators for now, because it is not presented in this case. This Court need not decide whether the chairman of the FCC can wield appointment power in order to decide whether the Tax Court is an Executive "Department."

2. The Government assumes that every federal entity in Washington, D.C. must fit within one of three pigeonholes. Such attempts to squeeze a government entity into one "branch" or another are no more edifying or helpful to constitutional analysis than trying to define "rigid categories" of "executive" or "quasi-legislative" officials. *Morrison v. Olson*, 487 U.S. 664, 689 & n.28 (1988). The Framers "rejected the notion that the three Branches must be entirely separate and distinct," *Mistretta v. United States*, 109 S.Ct. 647, 659 (1989), and this Court has "recognized the constitutionality of a 'twilight area' in which the activities of the separate Branches merge." *Id.* at 662. In any event, the questions of the existence and constitutionality of a headless "fourth branch" of government are not before the Court today, and no majority of this Court has ever endorsed the government's procrustean approach to the separation of powers, much less applied that approach in resolving a challenge under the Appointments Clause.

3. There are powerful reasons to doubt that the Tax Court is in the Executive Branch. The Government admits that the Tax Court's fit within the Executive Branch is not "perfect." (GB 41). That is a marvel of understatement, given the Government's own concession that, in 1969, Congress expressly repealed "the language explicitly stating that the Tax Court was an agency in the Executive Branch" (GB 39), precisely because it wished "to distance the Tax Court from the Executive Branch." (GB 41 n.33). Under the public rights doctrine, perhaps Congress could have put the resolution of tax disputes entirely in the hands of executive officials in the Internal Revenue Service, along with their other duties; but it is undeniable that in 1969 Congress chose not to do so.[8]

The Article I Tax Court functions in its entirety in a purely judicial capacity. In contrast, for example, to the Cabinet Departments and the independent regulatory commissions, the Tax Court formulates no regulatory policy, promulgates no substantive rules of conduct, brings no lawsuits or enforcement actions, prepares no position papers, gives no policy advice, investigates no problems

---

Federal Convention of 1787 627 (1966). (A94). Statutes providing for appointments by officials other than "Heads of Departments" or the President alone, subject to review and approval by the President or a Department Head, have long been enacted by Congress and sustained as constitutional. *See, e.g., Germaine*, 99 U.S. at 54; *United States v. Mouat*, 124 U.S. 303, 307-08 (1888).

[8] The government relies upon the 1969 Act's statement that the new Article I Tax Court is "'a continuation of the Tax Court of the United States as it existed prior to the date of enactment of this Act'" (GB 40), to establish that Congress "implicitly intended no substantive change in the Tax Court." (GB 40). As both the context of that provision and the legislative history make plain, however, this statement meant only that "the bill is to have no effect upon existing litigation, jurisdiction, etc.," so that all would know that Tax Court operations and pending cases had not been interrupted. S.Rep. No. 552, 91st Cong., 1st Sess. 305 (1969). The Report makes plain that Congress stripped the Tax Court of its "constitutional status as an executive agency, no matter how independent." *Id.* at 302.

The government also argues that the sitting Tax Court judges could not be continued in office without re-appointment by the President and Senate if Congress had in fact "reconstituted the Court outside the Executive Branch" (GB 40), relying on *Olympic Fed. Sav. & Loan Ass'n v. Director*, 732 F.Supp. 1183 (D.D.C. 1990). But *Olympic* in fact held that Congress *is free to* "chang[e] the duties" of or transform an "office" without Appointments Clause constraint so long as it leaves in place *all* the incumbent officers and does not pick and choose among them. *Id.* at 1193. *See Shoemaker v. United States*, 147 U.S. 282, 301 (1893). Congress did just that when it moved the Court of Claims out of the Article III Judiciary and reconstituted it as an Article I court in 1982. (PB 38 & n.35).

and administers no programs. All it does is adjudicate tax disputes and perform the usual ancillary tasks, like issuing its own procedural rules.

Since it has no part whatsoever in executing the law, it is unsurprising that the Tax Court is in no way under the control or supervision of the Executive Branch. Although the President appoints Tax Court judges, he may remove them only for cause, *see* 26 U.S.C. § 7443(f), which effectively precludes "coercive influence." *Mistretta*, 109 S.Ct. at 675. In contrast to Departments and agencies, the Tax Court is not subject to the Executive Branch administrative apparatus orchestrated by the Office of Management and Budget, nor is it subject to Executive Orders, inquiries, or supervision. *See* H. DuBroff, *The United States Tax Court: An Historical Analysis* 190 & n.177, 215 n.351 (1979). The President cannot oversee the Tax Court's operations because its budget, unlike those of Executive Departments, agencies and regulatory commissions, goes directly to Congress rather than to OMB. *Id.* at 215. For all intents and purposes, the Tax Court is " 'an instrumentality of the United States Government independent of the executive departments.' " *Bowsher v. Synar*, 478 U.S. 714, 730 (1986).

4. The flipside of this lack of supervision by the President (which the government does not and cannot contest) is lack of protection by the President. Without the lifeline to the White House enjoyed by Departments, agencies and commissions, the Tax Court is vulnerable to congressional influence. Its budget goes before Congress without the President or any other Executive Officer as its champion and intermediary. Tax Court judges' salaries can be reduced. Although it might be possible to argue that "Departments" encompasses more than those entities subject to a significant degree of presidential control, the government admits that, under the Appointments Clause, the term " 'Departments' is limited to Executive Branch Departments *protected* from [congressional] encroachment by the various constitutional powers of the Chief

Executive." (GB 9) (emphasis added). The government further admits that, "[w]ere the Tax Court . . . outside the scope of those protections, it would be subject to precisely the sort of congressional interference in the appointments process that the Appointments Clause was designed to forestall." (GB 9-10). (*See also* GB 37-38). Yet once one examines the actual relationship of the Tax Court to the rest of the federal government, it becomes clear that the Tax Court enjoys no real presidential protection beyond the empty label "Department" that the government would bestow.

5. If the Tax Court were an Executive "Department," incongruous results would be inescapable; indeed, the government has not disputed them. First, the Tax Court would be subject to a host of statutes governing executive administration—the Administrative Procedure Act, the Freedom of Information Act, the Ethics in Government Act—even though Congress reconstituted the Tax Court in 1969 as an Article I court precisely to avoid such anomalies. (PB 29-30). Second, the Chief Judge of the Tax Court, as the principal officer of an Executive Department, would be required by Art. II, § 2, cl.1 to provide the President with his opinion in writing on any subject within his office, which consists entirely of pending tax cases, in defiance of both congressional intent and the ban on Tax Court advisory opinions. *See Roderick v. Comm'r*, 57 T.C. 108, 112-13 (1971); (PB 30 n.27).[9]

[9] This Court held long ago in *Germaine* that "[t]he word 'department,' in both these instances [the Appointments and Opinion Clauses of Art. II], clearly means the same thing, and the principal officer in the one case is the equivalent of the head of department in the other." 99 U.S. at 511. The Framers in fact used the phrases so interchangeably that when the Opinion Clause was recorded as proposed in the words "principal officer in each of the Executive Departments," and then voted on and adopted (without record of any intervening amendment) in the words "Heads of Departments," no one noticed or remarked on the difference. *See* 2 M. Farrand, *supra*, at 541-43.

6. Even if the Tax Court were somehow shoe-horned into the Executive Branch, that would not render it a full-fledged Executive "Department." Surely more than one type of entity—possessing more than one defined set of duties and powers—is possible within the Executive Branch, just as there are different types of organizational entities within the Legislative (the two Houses of Congress, the Government Accounting Office, the Library of Congress) and Judicial Branches (the Judiciary, the United States Sentencing Commission, *see Mistretta*, 109 S.Ct. at 663).

As demonstrated above, the Tax Court's relationship with the President and the Executive Branch lacks any of the indicia of an Executive "Department." Nowhere in the corpus of federal laws and regulations is the Tax Court referred to as a "Department." Congress, which certainly knows how to "creat[e] these subdivisions of the executive branch by giving to each of them the name of a department," *Germaine*, 99 U.S. at 510-11, did not do so with respect to the Tax Court. Indeed, the government's own reference for what it calls the "free-standing agencies of the Executive Branch" *omits* the Tax Court. *See* 55 Fed.Reg. 44,196 (1990). Instead, the Office of the Federal Register describes the Tax Court as "an independent judicial body in the legislative branch." Office of the Federal Register, Nat'l Archives and Records Admin., *The United States Government Manual* 76 (1989/1990).

This Court has never defined "Department" for Appointments Clause purposes to include Article I tribunals such as the Tax Court. *See Germaine*, 99 U.S. at 511; *Burnap*, 252 U.S. at 515. The government dismisses these decisions, contending that this Court's characterizations of the Executive Branch Departments "were simply descriptive of the composition of the Executive Branch of government at the time." (GB 44). The government is quite mistaken, for the establishment of Article I courts predates both of those decisions by several decades. The

government would have us believe that, when Justice Brandeis defined "Department" for a unanimous Court in *Burnap* in 1920 in a way that excluded Article I courts, he was simply ignorant of the fact that such tribunals had existed for nearly a century.[10]

The most natural reading of the term, as well as the one supported by the history of each provision, is that "Department" means the same thing each time it is used in describing the Executive power under Article II—in the Appointments Clause, the Opinion Clause, and the 25th Amendment (which amends Art. II). The government embraces this canon of construction when it suits its purposes. Thus the government agrees with petitioners that the term "Courts of Law" in the Appointments Clause denotes the same "Courts" referred to in Article III. (GB 36). Yet the government argues that the phrase "Heads of Departments" in the Appointments Clause is broader than the phrase "principal Officers of the executive Departments" used in the Opinion Clause and the 25th Amendment, and suggests that the former phrase must therefore be deemed to include Article I tribunals. (GB 45-46). But it has long been held that the two phrases mean exactly the same thing. *See supra* n.9.[11]

[10] Article I courts date to at least as early as Chief Justice Marshall's decision sustaining their constitutionality in *American Ins. Co. v. Canter*, 26 U.S. (1 Pet.) 511 (1828). The Court of Claims was established in 1855. *See Williams v. United States*, 289 U.S. 553, 562 (1933). The Court of Private Land Claims was established in 1891. *See United States v. Coe*, 155 U.S. 76, 84 (1894). The Choctaw and Chickasaw Citizenship Court was established in 1902. *See Wallace v. Adams*, 204 U.S. 415, 417 (1907).

[11] In any event, what is at issue is the meaning of the term *"Department,"* and even if one assumes that the Chief Judge of the Tax Court is the "Head" of that tribunal in some sense, that does not make the Tax Court an "Executive Department" as the government claims. Even if the chairmen of the independent regulatory commissions (such as the SEC, FTC) could be deemed "Heads of Departments" because they are the President's chosen lieutenants,

7. The government does not dispute the proposition that the Framers feared the appointment power and were anxious to limit its dispersion to officers protected by checks and balances from congressional encroachment, either by Article III tenure (the Courts of Law) or by the mantle of the President (the Heads of Departments). (PB 24-26). Yet the government's theory that every "free-standing" agency it deems to be within the Executive Branch is a full-fledged "Department" would confer the power to appoint inferior officers on the Article I courts, which are beyond the President's supervision and protection, and perhaps on other entities as well. The government would thus reverse the decision of the Constitutional Convention to limit diffusion of appointment power because the government, like the Convention's dissenting voice, James Madison, believes that the Appointments Clause "does not go far enough." 2 M. Farrand, *The Records of the Federal Convention of 1787* 627 (1966). But the Framers have *already* expressly taken the practical needs of government into account, *see id.*, and weighed them against the need to control the diffusion of appointment power and to provide an effective separation of powers. It is not up to the Court or Congress to restrike that balance.[12]

see D. Welborn, *Governance of Federal Regulatory Agencies* 6-7, 37, 141 (1977) (although commissioners are appointed to fixed terms, the chairman generally holds that special post at the President's pleasure), and because their agencies are part of the executive apparatus for enforcing and administering the laws and programs enacted by Congress, the Chief Judge of the purely adjudicatory Tax Court (who is chosen by his fellow judges, 26 U.S.C. § 7444(b)) cannot be put in the same category.

[12] The government's reliance on the statement of Rufus King (GB 47-48) is inapposite. The government's ellipses conceal the fact that King was speaking of the impracticality of appointment of "minute officers"—he seems to have been referring not to inferior officers but to ministerial employees—by the Senate or an Excutive Council, rather than by the President himself. 2 M. Farrand, *supra*, at 539. King's remarks were made on September 7, 1787, a full week before the provision of the Appointments Clause at issue in this case was even proposed. *See id.* at 627.

III. THERE WAS NO AND CAN BE NO WAIVER IN THIS CASE

1. The government fails in its attempt to depict this Court as concerned only about the prerogatives of the Article III courts, and as generally unconcerned about maintaining the integrity of the Constitution's other structural elements. Neither *CFTC v. Schor*, 478 U.S. 833 (1986), nor *Pacemaker Diagnostic Clinic v. Instromedix*, 725 F.2d 537 (9th Cir.) (*en banc*), *cert. denied*, 469 U.S. 824 (1984), purported to distinguish among structural principles and to require attention to some while relegating others to the vagaries of waiver rules and litigation strategies.[13] Indeed, the government is unable to identify even a single case in which any court has endorsed its proposed distinction between the structural principles of Article III and all others. Most recently, the Second Circuit squarely rejected the government's analysis in the related *Samuels, Kramer* case:

> Structural protections such as those embodied in the Appointments Clause stand on a different footing from personal constitutional rights. As the Supreme Court has stated, "[t]o the extent that [a] structural principle is implicated in a given case, the parties cannot by consent cure the constitutional difficulty." *Schor*, 478 U.S. at 850-51. . . . Were such institutional interests—as distinguished from personal constitutional rights—so easily waived, the affirmative requirements imposed by the Appointments Clause would effectively be rendered null and void.

(GSB App. 17a-18a). It was therefore appropriate for this Court to reach and decide the Appointments Clause

[13] Both *Schor* and *Pacemaker* did, however, distinguish between the personal rights element of a constitutional provision, which may be waived, and the structural element, which cannot. The government does not contest that the Appointments Clause has no personal rights element but only structural implications. (PB 45).

issues supposedly waived by the parties in *Glidden v. Zdanok*, 370 U.S. 530 (1962), and *Lamar v. United States*, 241 U.S. 103 (1916). (PB 42-43). Those were not, unlike *Schor*, cases of alleged encroachment on the Article III Judiciary, but rather Appointments Clause cases that happened to involve the appointment of judicial officers, and they are fully applicable here.

2. The government's plea that this Court defer to the Executive's assessment of Appointments Clause challenges and rely upon the President to pursue all such issues should also be rejected. (GB 23-24). The fact that the Solicitor General was a party in both *Glidden* and *Lamar* did not move this Court to enforce the private party's waiver of his Appointments Clause claim, and for good reason. The President may have his own competing reasons for signing a law that he deems unconstitutional, and the Executive, like any other party to litigation, may act for short-term advantage to preserve a given judgment or to serve some competing end that, for the moment, it values more highly than the Appointments Clause. For example, in the instant case it is unsurprising that the government prefers to overlook a serious Appointments Clause question, since consideration of that question may threaten a special trial judge's resolution of test cases that, if sustained, may garner the Treasury more than $1.5 billion in tax revenue. (PB 1).[14]

[14] The government attempts to color the Court's attitude by focusing on facts supposedly showing petitioners' transactions to be "shams." (GB 2-6). But if either the Tax Court or the Fifth Circuit had ever actually examined the record, rather than just the special trial judge's report, they would have found much evidence that there was economic substance to petitioners' trades—including the taxes petitioners paid on their trading profits. The special trial judge simply disregarded weeks of testimony by petitioners' three experts, who closely examined petitioners' *actual* transactions, in favor of the testimony of the government's one witness, who never looked at the actual transactions but instead analyzed hypothetical transactions loosely based on the investment company's trading program.

But what is best for the Executive Branch, either in a particular case or in the long run, is not necessarily what is best for the Republic. The structural principles embodied in the Appointments Clause do not, simply because they are located in Article II, speak only or even primarily to Executive prerogatives. Power to appoint inferior officers does not belong to *any* branch or official until Congress creates an office and assigns the appointing power. The government is therefore grossly mistaken in assuming that all that is at stake here is its own appointment "perks." The structural interests protected by the Appointments Clause are not those of any one branch, but of "We the People."

3. Even if such a structural challenge could be waived, petitioners' mid-trial "consent" to the assignment of this case to a special trial judge was involuntary. For all of its comments about insincerity and "crocodile tears" (GB 22), the government does not dispute the coercive burden imposed on petitioners when they were offered the "choice" between abandoning 19 months of trial and consenting to having a special trial judge conclude the case. (PB 49-50). When the alternative involves such "measurable hardships," *Pacemaker*, 725 F.2d at 543, "consent" to finishing the trial before a constitutionally suspect presiding officer cannot deprive a party of the right to challenge that officer's appointment and to seek retrial before a properly constituted tribunal. *Id.*

4. Finally, judicial economy would be served by resolving this important Appointments Clause issue here and now. The identical issue is presented in the related *Samuels, Kramer* case just decided in the Second Circuit and, as the government notes (GSB 2), there is no waiver or consent issue there. The petitioners in *Samuels, Kramer*, who are represented by the same counsel as petitioners here, will soon file a Petition for Writ of Certiorari in that case. Since this issue has been fully ventilated in these proceedings, no purpose would be served by

failing to reach and decide it now rather than in the coming Term.

CONCLUSION

For these reasons, the judgment below should be reversed and this case remanded for a new trial.

Respectfully submitted,

KATHLEEN M. SULLIVAN
Counsel of Record

BRIAN STUART KOUKOUTCHOS
1525 Massachusetts Avenue
Cambridge, MA 02138
(617) 495-4633

RICHARD J. SIDEMAN
MARTHA A. BOERSCH
SIDEMAN & BANCROFT
One Embarcadero Center
Suite 860
San Francisco, CA 94111
(415) 392-1960

April 16, 1991

Counsel for Petitioners